

Legislative Audit Division

State of Montana



Report to the Legislature

December 2005

Financial Audit

For the Fiscal Year Ended June 30, 2005

The University of Montana

A Component Unit of the State of Montana

We performed a financial audit of The University of Montana's consolidated financial statements for the fiscal year ended June 30, 2005. These financial statements present the financial position, the results of operations, and cash flows, on a consolidated basis, of all four campuses affiliated with The University of Montana: The University of Montana-Missoula; Montana Tech of The University of Montana (located in Butte); The University of Montana-Western (located in Dillon); and The University of Montana-Helena College of Technology.

The statements include component unit financial information as required under GASB 39. This report contains an unqualified opinion on the university's financial statements and accompanying notes for the fiscal year ended June 30, 2005, and the comparative information for the fiscal year ended June 30, 2004. This opinion means the reader may rely on the financial statement information presented. Supplemental Information on page A-43 is presented for additional analysis.

This audit is performed to attest to the fairness of the consolidated financial statements of The University of Montana. Audit issues, if any, identified during this audit have been discussed with university management and, if appropriate, will be reported in our financial-related audit of the university for the two fiscal years ended June 30, 2007.

Direct comments/inquiries to:
Legislative Audit Division
Room 160, State Capitol
PO Box 201705
Helena MT 59620-1705

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FINANCIAL AUDITS

Financial audits are conducted by the Legislative Audit Division to determine if the financial statements included in this report are presented fairly and the agency has complied with laws and regulations having a direct and material effect on the financial statements. In performing the audit work, the audit staff uses standards set forth by the American Institute of Certified Public Accountants and the United States Government Accountability Office. Financial audit staff members hold degrees with an emphasis in accounting. Most staff members hold Certified Public Accountant (CPA) certificates.

Government Auditing Standards, the Single Audit Act Amendments of 1996 and OMB Circular A-133 require the auditor to issue certain financial, internal control, and compliance reports. This individual agency audit report is not intended to comply with these requirements and is therefore not intended for distribution to federal grantor agencies. The Legislative Audit Division issues a statewide biennial Single Audit Report which complies with the above reporting requirements. The Single Audit Report for the two fiscal years ended June 30, 2005, will be issued by March 31, 2006. The Single Audit Report for the two fiscal years ended June 30, 2003, was issued on March 23, 2004. Copies of the Single Audit Report can be obtained by contacting:

Single Audit Coordinator
Office of Budget and Program Planning
State Capitol
Helena MT 59620
Phone (406) 444-3616

Legislative Audit Division
Room 160, State Capitol
PO Box 201705
Helena MT 59620-1705

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James Gillett, Financial-Compliance Audit

December 2005

The Legislative Audit Committee
of the Montana State Legislature:

This is our financial audit report on The University of Montana's consolidated financial statements for the fiscal year ended June 30, 2005. The statements include comparative information for the fiscal year ended June 30, 2004. The University requested this audit to provide timely audited financial statements to interested parties. The objective of our audit was to determine if The University's financial statements present fairly its financial position, changes in its financial position, and its cash flows as of and for the fiscal year ended June 30, 2005. This objective included determining The University's compliance with laws and regulations having a direct and material impact on the financial statements. Our opinion for fiscal year 2004 is based on the audit we performed in the fall of 2004.

The University of Montana consists of campuses located in Missoula, Butte, Dillon, and Helena. The campuses are accredited by the Commission on Colleges of the Northwest Association of Schools and Colleges and provide a diversity of undergraduate and graduate academic and two-year vocational/technical programs to students.

The University of Montana-Missoula is a comprehensive university offering four-year undergraduate programs along with master and doctoral graduate programs. It includes professional schools and significant research activities. The campus is the center of liberal arts education in the Montana University System and operates the only law school in the system. Other schools include business administration, education, fine arts, forestry, pharmacy and allied health services, and journalism. In addition, the campus includes a two-year college of technology that provides a broad range of technical and occupational education and training courses.

Montana Tech of The University of Montana provides a variety of four-year and graduate programs with a focus on mineral, geological, environmental, petroleum, mining, and other engineering and science programs and majors. It also includes a college of technology that provides two-year degrees in various occupational and technical programs and core education courses.

The University of Montana-Western provides both two-year and four-year undergraduate degree programs with a focus on elementary and secondary education. It also provides a four-year liberal arts degree with several emphases that complement the education programs.

The University of Montana-Helena College of Technology provides two-year Associate of Science degree programs and a variety of other occupational, technical, and training specialties. These areas include accounting technology, carpentry, computer technology, practical nursing, electronics technology, and welding technology. The college is expanding its offerings and will serve as a higher education center by offering certain courses transferable to degree programs offered at other campuses of the Montana University System.

A list of Appointed and Administrative Officials having oversight responsibilities with respect to The University of Montana can be found on page i.

Beginning on page A-1, you will find the Independent Auditor's Report followed by The University's financial statements and accompanying notes. We issued an unqualified opinion on The University's consolidated financial statements, which means the reader can rely on the presented information.

This report does not contain any recommendations to The University. Audit issues, if any, identified during this audit have been discussed with university management. The University's response to this report is on page B-1.

We thank President Dennison and his staff for their cooperation and assistance during the audit.

Respectfully submitted,

/s/ Scott A. Seacat

Scott A. Seacat
Legislative Auditor

Appointed and Administrative Officials

Board of Regents of Higher Education

Brian Schweitzer, Governor*
Linda McCullough, Superintendent of Public Instruction*
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Stephen M. Barrett, Regent
Mark Semmens, Regent
Lila Taylor, Regent

*Ex officio members of the Board of Regents

Commissioner of Higher Education

Sheila M. Stearns	Commissioner of Higher Education*
Rodger Barber	Deputy Commissioner for Academic and Student Affairs
Mick Robinson	Associate Commissioner for Fiscal Affairs
David Gibson	Associate Commissioner for Economic Development and Outreach
Pam Joehler	Director of Budget and Accounting
Cathy Swift	Chief Legal Counsel

The University of Montana, All Campuses

George M. Dennison	President
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The University of Montana-Missoula

Lois Muir	Provost and Vice President, Academic Affairs
Robert Durringer	Vice President for Administration and Finance
Daniel J. Dwyer	Vice President for Research and Development
Teresa S. Branch	Vice President for Student Affairs and University Vice President
David Aronofsky	Legal Counsel
James R. Darcy	Director of Business Services

Appointed and Administrative Officials

Montana Tech of The University of Montana

W. Franklin Gilmore	Chancellor and University Executive Vice President
Susan B. Patton	Vice Chancellor for Academic Affairs and Research and University Associate Provost
Joseph F. Figueira	Associate Vice Chancellor for Academic Affairs and Research, Dean of the Graduate School
John C. Badovinac	Controller/Business Manager
Lynn Job	Director of Contracts and Grants

The University of Montana- Western

Richard Storey	Chancellor
Karl E. Ulrich	Provost and Vice Chancellor for Academic Affairs, University Associate Provost
Susan D. Briggs	Vice Chancellor for Administration and Finance, University Associate Vice President
Virginia Dale	Director of Business Services

The University of Montana- Helena College of Technology

Daniel Bingham	Dean/CEO
(Vacant)	Associate Dean for Academic Affairs
Cristobal Valdez	Associate Dean, Student Services
Russ Fillner	Associate Dean, Fiscal and Plant

For further information on The University of Montana (All Campuses) contact:

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Members of the audit staff involved in this audit were Pearl M. Allen, Danielle Gamradt, Paul J. O'Loughlin, Sonia Powell, Vickie Rauser, Jeff Tamblyn, Lena Tamcke, and Amber Thorvilson.

LEGISLATIVE AUDIT DIVISION

Scott A. Seacat, Legislative Auditor
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Tori Hunthausen, IS Audit & Operations
James Gillett, Financial-Compliance Audit

INDEPENDENT AUDITOR'S REPORT

The Legislative Audit Committee
of the Montana State Legislature:

We have audited the accompanying Consolidated Statements of Net Assets of The University of Montana, a component unit of the state of Montana, as of June 30, 2005, and 2004, and the related Consolidated Statements of Revenues, Expenses and Changes in Net Assets and Consolidated Statements of Cash Flows for the fiscal years then ended and the Combined Statements of Financial Position-Component Units as of June 30, 2005, and 2004, and the related Combined Statement of Activities-Component Units for the fiscal years then ended. The information contained in these financial statements is the responsibility of the university's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the university's aggregate discretely presented component units. Those statements, which include The University of Montana Foundation, the Montana Tech Foundation, The University of Montana-Western Foundation, and the Montana Grizzly Scholarship Association, were audited by other auditors whose reports thereon have been furnished to us, and our opinion insofar as it relates to the amounts included for the component units of the university, as noted above, are based on the reports of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of The University of Montana and the aggregate discretely presented component units as of June 30, 2005, and 2004, and the respective changes in financial position and cash flows, where applicable, for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages A-3 through A-11 is not a required part of the financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

The Supplemental Information on page A-43 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Respectfully submitted,

/s/ James Gillett

James Gillett, CPA
Deputy Legislative Auditor

November 9, 2005

**The University of Montana's
Management Discussion and Analysis,
Financial Statements, and Notes**

THE UNIVERSITY OF MONTANA

THE UNIVERSITY OF MONTANA - MISSOULA

THE UNIVERSITY OF MONTANA - WESTERN

THE UNIVERSITY OF MONTANA - HELENA COLLEGE OF TECHNOLOGY

MONTANA TECH OF THE UNIVERSITY OF MONTANA

MANAGEMENT'S DISCUSSION AND ANALYSIS FISCAL YEAR ENDED JUNE 30, 2005

OVERVIEW

The University of Montana (University) is comprised of four campuses: The University of Montana - Missoula; The University of Montana - Western; The University of Montana - Helena College of Technology; and Montana Tech of The University of Montana. This discussion addresses the consolidated financial statements for the four campuses, and included are three basic statements: the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and the Statement of Cash Flows.

The discussion and analysis which follows provides a comparative overview of the University's financial position and operating results for the fiscal years ended June 30, 2005, 2004, and 2003 and should be read in conjunction with the fiscal year 2005 financial statements.

INCLUSION OF COMPONENT UNITS

In May of 2002, the Governmental Accounting Standards Board (GASB) issued Statement No. 39, "Determining Whether Certain Organizations are Component Units". This guidance was applied to financial statements for accounting periods which began after June 15, 2003, or in our case for the financial statements for the fiscal year ended June 30, 2004. Accordingly, we include in our financial statements information on four entities which qualify as component units. Those are The University of Montana Foundation, the Montana Tech Foundation, The University of Montana - Western Foundation, and the Montana Grizzly Scholarship Association.

These four component units are legally separate, tax-exempt entities that issue their own financial statements in a format promulgated by the Financial Accounting Standards Board (FASB), and not by GASB. As a result, their financial information is issued on separate pages from the consolidated financial information of the four campuses. For those component units we have provided a Statement of Financial Position and a Statement of Activities- both presented in a "consolidated" format. More detailed information about the individual component units is provided in the notes to the financial statements.

FINANCIAL HIGHLIGHTS

The financial highlights for fiscal year 2005 were:

- Tuition rate increases for the year ended June 30, 2005 were 8.5% for the Missoula and Western campuses, 12% for the Montana Tech campus, and 6% for all of our Colleges of Technology. The resulting tuition revenue increase, net of scholarship allowances, for the 2005 fiscal year was nearly \$4.4 million.
- Net Assets of the University increased by more than \$7.8 million. The largest single source of that increase was a \$3.4 million endowment from the National Institute of Health to the School of Pharmacy and Allied Health Sciences for training, educating, and supporting research by minority

faculty and students. The other major source was \$2.8 million which is associated with a number of capital projects.

- Investment earnings increased significantly by about \$1.25 million in FY 05. This is primarily attributable to higher yields on interest bearing investments. The Federal Open Market Committee raised the benchmark short term interest rate- the federal funds rate- several times during the year, resulting in progressively higher yields over the course of the year.
- Considerable attention was given during FY 04 to a deficit experienced by the UM Athletics Department at the Missoula campus. A number of mechanisms related to control, monitoring and reporting on the Athletics Department financial status were implemented as a result. A plan was put in place to eliminate the accumulated deficit in the Athletics Department within five years. During FY 05, Athletics significantly exceeded the targets of the deficit elimination plan, and the deficit was reduced by \$400,000 from \$962,626 at June 30, 2004 to \$562,626 at June 30, 2005.

The financial highlights for fiscal year 2004 were:

- Tuition increased 8.75% at the Missoula and Western campuses and 12% at the Montana Tech campus for both resident and non-resident undergraduate and graduate program students for the year ended June 30, 2004. Tuition increased 6% at the College of Technology campuses for the same period. The tuition increase resulted in approximately \$3.1 million in increased tuition revenue, net of scholarship allowances in FY 04.
- The University issued \$40,490,000 of Series I Refunding and Facilities Improvement Revenue Bonds in April 2004, at rates which ranged from 3.00% to 4.75%. The proceeds of the issuance were used to pay and discharge \$30,725,000 of Facilities Improvement and Refunding Revenue Bonds, Series A 1993, to help fund an addition to the School of Pharmacy and to perform various deferred maintenance projects at the Missoula campus.
- Federal contract and grant revenue increased by approximately \$8.1 million, from \$56.6 million to \$64.7 million in FY 04. The Pharmacy School on the Missoula campus was the single largest source of that increased revenue.

USING THE FINANCIAL STATEMENTS

The University's financial statements consist of the following three statements: Statement of Net Assets, Statement of Revenues, Expenses and Changes in Net Assets, and Statement of Cash Flows.

In addition, we prepare and present a Statement of Activities and a Statement of Financial Position for the four component units mentioned previously. A discussion of each of the individual statements follows. Some key points to be aware of regarding the statements are:

- These are consolidated financial statements representing the University's four campuses and the component units mentioned previously.
- The financial statements are prepared using the accrual basis of accounting, which means revenues are reported when earned, and expenses are reported when incurred.
- Assets and liabilities presented in the financial statements are generally measured at current value, although capital assets are stated at historical cost less accumulated depreciation.

- Capital assets are classified as depreciable and non-depreciable. Depreciation is treated as an operating expense.
- Assets and liabilities are treated as current (Due within one year) or as non-current (Due in more than one year), and are presented in the Statement of Net Assets in order of liquidity.
- Revenues and expenses are classified as operating or non-operating. “Operating” is defined as resulting from transactions involving exchanges of goods or services for payment, while “non-operating” is defined as resulting from transactions not involving the exchange of goods or services for payment. We show a substantial operating loss on the Statement of Revenues, Expenses, and Changes in Net Assets primarily because GASB requires that General Operating Fund expenses be reported as operating, while the State Appropriation - which is General Operating Fund revenue - must be reported as non-operating.
- Tuition and fees are reported net of any scholarships or fellowships that were applied directly to a student’s account. The reason for “netting” these is to keep the University financial statements from “double counting” this revenue and expense.

STATEMENT OF NET ASSETS

The Statement of Net Assets reflects the financial position of the University at the end of the fiscal year. The changes in net assets that occur over time indicate improvements or deterioration in the University’s financial position. A summary of the Statement of Net Assets follows:

<u>Description</u>	For the years ended June 30, (stated in millions)		
		(Restated)	(Restated)
	2005	2004	2003
Total current assets	\$ 84.30	\$ 76.41	\$ 68.67
Total non-current assets	273.70	275.07	263.74
Total assets	\$ 358.00	\$ 351.48	\$ 332.41
Total current liabilities	\$ 44.73	\$ 42.66	\$ 39.85
Total non-current liabilities	159.37	162.70	154.23
Total liabilities	204.10	205.36	194.08
Invested in Capital Assets, Net of Related Debt	105.95	108.32	107.98
Restricted			
Nonexpendable	15.68	12.16	9.63
Expendable	5.31	5.36	4.48
Unrestricted	26.96	20.28	16.24
Total net assets	153.90	146.12	138.33
Total liabilities and net assets	\$ 358.00	\$ 351.48	\$ 332.41

Events or developments that occurred which had a significant impact on the Statement of Net Assets include:

Events or developments which occurred during 2005:

- Current assets increased by more than \$7.8 million, with most of that change resulting from an increase in cash and cash equivalents of \$4.3 million. That increase was comprised primarily of

\$1.3 million from grant and contract activity and \$2.1 million from plant fund investments which matured in FY 05 and will be used to pay for a major capital project. Also, investments increased by more than \$4.5 million. Most of that increase is attributable to U.S. Treasury Securities which were reclassified in FY 05 to current assets because they will mature during FY 06. These investments were from bond proceeds which were received at the end of FY 04, and are to be used for funding the capital project referred to above.

- Total Liabilities decreased by about \$1.3 million. The major type of liability that decreased (by \$4.4 million) was long term obligations. Conversely, a number of types of liabilities showed increases, with the largest being about \$ 900,000 in the current portion of long term debt. Smaller increases of \$400,000 to \$500,000 each were recognized in accounts payable and accrued liabilities; due to primary government; deferred revenue; accrued compensable absences; and advances from primary government.
- Net Assets increased significantly by \$7.8 million. The largest single contributor to this was the \$3.4 million NIH endowment made to the School of Pharmacy and Allied Health Sciences.

Events or developments which occurred during 2004:

- Sale in August 2003 of approximately \$9 million invested in the Montana Board of Investments Trust Fund Bond Pool. This had the effect of increasing current assets – cash and cash equivalents while decreasing current assets – investments in FY 04.
- Issuance of \$40,490,000 of Series I Refunding and Facilities Improvement Revenue Bonds in April 2004 and subsequent retirement of approximately \$30,540,000 of Series A Facilities Improvement and Refunding Bonds. This had the net effect of increasing liabilities-long term obligations, while also increasing non-current assets – other long-term investments in FY 04.
- Capitalization of approximately \$11,000,000 of costs related to the Lewis and Clark Village student housing complex. This had the effect of increasing non-current assets- capital assets, net accompanied by either decreases to non-current assets – restricted cash and cash equivalents or increases to various liability accounts in FY 04.
- Recording of prior period adjustments. In 2004, it was determined that two transactions that occurred during previous fiscal years were incorrectly reported. The correction of these transactions has resulted in a restatement of the consolidated financial statements for the year ending June 30, 2003.

The first item requiring restatement is an endowment investment that originated in the year ending June 30, 2002. This investment and the associated income and expenses were originally reflected on the financial statements of the University of Montana Foundation. Since then, it has been determined that the investment and associated revenues and expenses should be recorded by the University of Montana and that the investment will be managed by the University of Montana Foundation. This has resulted in a restatement on the Statement of Net Assets as of June 30, 2003 of approximately \$4,400,000 and a restatement of activity on the financial statements for that fiscal year.

The second item is a liability that was previously unrecorded on the University's consolidated financial statements. This liability originated from a loan by the Montana Science and Technology Alliance (MSTA). The loan, which matures in 2061, was issued in 1994 and the amounts received by the University were incorrectly recorded as revenue and payments on the

loan as expenses. The correction of this has resulted in a restatement of approximately \$3,600,000 on the Statement of Net Assets as of June 30, 2003.

STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

The Statement of Revenues, Expenses, and Changes in Nets Assets present the results of the University's operational activities for the fiscal year, categorizing them as either operating or non-operating items. See Consolidated Statements Financial Statement Note 2, "Summary of Significant Accounting Policies" for further explanation. Consistent with the accrual method of accounting, the current year's revenues and expenses are recognized when they were earned or incurred, regardless of when cash was received or paid.

A summary of the Statement of Revenues, Expenses and Changes in Net Assets follows:

<u>Description</u>	For the years ended June 30,		
	(stated in millions)		
	2005	(Restated) 2004	(Restated) 2003
Operating revenue	\$ 218.18	\$ 206.14	\$ 193.49
Operating expenses	280.35	266.27	254.47
Operating loss	(62.17)	(60.13)	(60.98)
Non-operating revenues (expenses)	64.14	61.94	60.52
Income (loss) before other revenues	1.97	1.81	(0.46)
Other revenues	5.81	5.35	1.66
Net increase in net assets	7.78	7.16	1.20
Net assets, beginning of year, as adjusted	146.11	138.33	137.13
Prior Period Adjustments (Net)		0.62	
Net assets, end of year	\$ 153.89	\$ 146.11	\$ 138.33

The following provides a comparative analysis of revenues and expenses for the years ended June 30, 2005, 2004, and 2003:

REVENUES	For the years ended June 30,					
	(stated in millions)					
	2005		(Restated) 2004		(Restated) 2003	
	Amount	Percent	Amount	Percent	Amount	Percent
Tuition and fees, net	\$ 83.08	28.2%	\$ 76.60	27.4%	\$ 73.49	28.0%
Federal grants and contracts	65.67	22.3%	64.72	23.2%	56.63	21.6%
State & local grants/contracts	7.42	2.5%	5.64	2.0%	6.63	2.5%
Nongovernmental grants/contracts	3.99	1.3%	4.80	1.7%	5.32	2.0%
Indirect cost recoveries	10.42	3.5%	9.70	3.5%	8.57	3.3%
Sales/services of educational departments	12.28	4.2%	10.51	3.8%	10.22	3.9%
Auxiliary enterprise charges	30.08	10.2%	29.56	10.6%	28.37	10.8%

State appropriations	56.70	19.2%	58.05	20.8%	55.28	21.1%
Private gifts	9.73	3.3%	8.45	3.0%	8.15	3.1%
Capital grants and gifts	5.81	2.0%	5.35	1.6%	1.66	0.6%
All other sources combined	9.55	3.3%	7.11	2.4%	8.10	3.1%
	<u>\$ 294.73</u>	<u>100.0%</u>	<u>\$ 280.49</u>	<u>100.0%</u>	<u>\$ 262.42</u>	<u>100.0%</u>

EXPENSES	Amount	Percent	Amount	Percent	Amount	Percent
Compensation and benefits	\$ 175.85	61.2%	\$ 168.37	61.6%	\$ 160.41	61.4%
Other operating expenses	72.73	25.4%	66.90	24.5%	63.73	24.4%
Scholarships and fellowships	15.70	5.3%	15.17	5.5%	14.73	5.6%
Depreciation and amortization	16.07	5.6%	15.84	5.8%	15.61	6.0%
Interest expense	6.60	2.5%	7.05	2.6%	6.75	2.6%
	<u>\$ 286.95</u>	<u>100.0%</u>	<u>\$ 273.33</u>	<u>100.0%</u>	<u>\$ 261.22</u>	<u>100.0%</u>

Comments about specific revenue and expense items are:

Events or Developments which occurred during 2005 include:

- Tuition and Fees (net) increased by about \$6.5 million, with about \$4.4 million being attributable to higher tuition rates, and the remainder to higher enrollments in FY 05.
- Our state and local contracts and grants grew fairly substantially (by about \$1.8 million, or more than 30%). Some efforts to secure contract and grant funding were refocused from federal to state sources, as federal awards became more difficult to obtain.
- State Appropriations decreased by about \$1.3 million. This is primarily attributable to the fact that the University of Montana asked for and was granted permission to “carry back” approximately \$732,000 of State Appropriation from FY 05 to FY 04. The purpose of this was to smooth out revenues in the general fund over the two years of the biennium which ended on June 30, 2005.
- Both revenues and expenses increased by about \$14.2 million and \$13.6 million, respectively. The relative percentages in the broad categories of expense were very consistent between the two years.
- Prior Period Adjustment. In 2005, it was determined that certain transactions that occurred during previous fiscal years were incorrectly reported. The correction of these transactions has resulted in a restatement of the consolidated financial statements for the year ending June 30, 2004. In the year ended June 30, 2003, the University was awarded an endowment through a federally sponsored endowment award program. The amounts received in the years ending June 30, 2003 and 2004 under the program were not properly reflected as an endowment investment on the University’s consolidated financial statements. This has resulted in a \$2,097,204 restatement of endowment investments on the consolidated Statement of Net Assets at June 30, 2004, and a restatement of \$993,051 to net assets – beginning of year, and other related activity on the consolidated Statement of Revenues, Expenses and Changes in Net Assets and Statement of Cash Flows for that fiscal year.

Events or Developments which occurred during 2004 include:

- Tuition and fees, net: Increases in tuition rates and some fee rates at all campuses was the primary reason for the 4.2% increase in tuition and fees, net.
- Federal contracts and grants and indirect cost recoveries. The 14.3% increase in revenue is attributable to a system wide focus on increasing our research dollars, with the Pharmacy School on the Missoula campus the single largest source of this revenue. A byproduct of the increase in federal contracts and grants is that indirect cost recoveries, which result from such federal contracts and grants, increased by 13.1% during the same period.
- State appropriations. State appropriations to the four campuses increased in FY 04 by about \$2.77 million, or 5%. Most of this increase is to help cover a significant increase in the cost of employee health insurance premiums.
- Capital grants and gifts. Capital grants and gifts increased by approximately \$2.8 million in FY 04. The increase was mainly due to the contribution received from the State of Montana Architecture and Engineering Agency for the renovation of the Chemistry building.
- Expenses: Overall expenses increased by \$12.1 million in FY 04. This was consistent with the \$14.3 million increase in total revenue, and the percent portions expended in various natural categories of expense, such as salaries, operating expenses, etc. was very consistent from 2003 to 2004.

STATEMENT OF CASH FLOWS

The Statement of Cash Flows provides information about the University's sources and uses of cash during the fiscal year. This statement aids in assessing the University's ability to meet obligations and commitments as they become due, their ability to generate future cash flows, and their needs for external financing. As required by GASB, the statement is presented using the "Direct Method", which focuses on those transactions that either provided or used cash during the fiscal year.

<u>CASH FLOW CATEGORY</u>	For years ended June 30,		
	(stated in millions)		
	2005	(Restated) 2004	(Restated) 2003
Cash Provided by(Used for):			
Operating Activities	\$ (43.95)	\$ (42.14)	\$ (42.82)
Non-capital Financial Activities	71.61	68.62	64.43
Capital and Related Financial Activities	(24.17)	(24.47)	(0.95)
Investing Activities	(3.06)	0.19	(9.52)
Net Increase in Cash	0.43	2.20	11.14
Cash and Cash Equivalents, beginning of year	57.60	55.40	44.26
Cash and Cash Equivalents, end of year	\$ 58.03	\$ 57.60	\$ 55.40

Specific events or cash transactions which occurred during FY 05 which were notable included:

- Regarding Cash flows from operating activities: The University generated about \$5.7 million more in cash inflow from Tuition and Fees in FY 05. Categories of cash outflows which increased most in FY 05 were about \$6 million for salaries and benefits, and \$5.5 million for operating expenses, which includes a \$1.5 million utility increase.
- Cash flowing in from noncapital financing activities increased approximately \$3 million from FY 04 to FY 05. The \$3.4 million NIH endowment award accounted for most of this.
- Investing activities were attributed with using about \$3.2 million more of cash in FY 05. This resulted primarily from converting investments into cash to provide cash for various plant fund projects and the sale (in FY 04) of funds invested in the Trust Fund Bond Pool.

Specific events or cash transactions outside the “everyday realm” of collecting revenues and paying obligations that had significant influence on the \$2.2 million increase in cash (a net cash inflow) during FY 04 were:

- The net proceeds from the Series I Revenue Bonds of \$40,490,000 were partially offset by the retirement of approximately \$30,500,000 of Series A Revenue Bonds, resulting in a net cash increase of about \$10 million.
- The sale of approximately \$9 million in the Montana Board of Investments Trust Fund Bond Pool in August 2003 had the effect of being a source of cash in the “Investing Activities” category.
- Large capital expenditures, primarily attributable to the Lewis and Clark Village student housing complex, led to our using significantly more cash to acquire capital assets in FY 04.

DISCUSSION OF SIGNIFICANT PENDING ECONOMIC AND FINANCIAL ISSUES

The issues we view as significant pending economic or financial issues for the four campuses of the University are:

- As of June 30, 2005, the University had either undertaken- or had plans to undertake within the next year- a number of new building construction projects. Those projects include an addition to the School of Pharmacy and Allied Health Sciences Skaggs Building (work was started by June 30, 2005; estimated cost of \$14 million) and a new building for the journalism school, Anderson Hall (construction started in July of 2005; estimated cost of \$12.5 million). In addition, four other major buildings were in the planning stage. The first was the Multi Disciplinary Research Building (not yet named; estimated cost of \$12 million), and the second the Gilkey Executive Education Center (estimated cost of \$5.1 million). The third was a new building to house the Helena College of Technology (estimated cost of \$7.5 million), and the fourth a building to be built adjacent to the new HCOT building, which will house the Office of the Commissioner of Higher Education and has an estimated cost is \$5 million.
- On September 15, 2005, the Board of Regents and the University issued \$31,095,000 of aggregate principal amount Facilities Improvement Bonds, Series J 2005. The proceeds from the issuance, combined with certain other funds and monies of the Board and the University, are being used for several purposes, including:
 - Providing funds to pay and discharge a portion of the Series F 1999 Facilities Improvement Bonds.

- Finance or refinance the costs of acquiring, constructing, furnishing, equipping, renovating, improving or repairing certain University facilities.
 - Paying a portion of the interest plus insurance premium and costs associated with the issuance of the Series J 2005 bonds.
- In addition, the University intends to refund the remaining unrefunded portion of the Series F 1999 bonds by issuing variable rate Parity Bonds in 2010 (Series K 2010 bonds) for a maximum principal amount of \$47 million. As part of that issuance, the University on August 26, 2005 entered into a forward swap Interest Rate Agreement with respect to the Series K 2010 bonds with Wachovia Bank. Under the terms of that agreement, the University will pay to Wachovia a fixed rate of interest equal to the interest on the Series K 2010 bonds while Wachovia Bank will pay to the University a floating rate based on the LIBOR rate. The purpose of this rate swap is to convert the variable rate Series K 2010 bond issue into a fixed rate obligation. Since the fixed rate payable by the University under this obligation was higher than interest rates on similar obligations at the time of agreement, the University received a payment of more than \$2 million from Wachovia Bank at the time the agreement was signed. Those funds were combined with the proceeds of the Series J 2005 bond issuance and will be used to pay costs associated with the Series J 2005 bonds.
- Utility costs continue to be a concern, especially with the rising natural gas rates over the last several years. In addition to the record 89% increase in the natural gas commodity price in FY 05, all but one campus will experience yet another increase of approximately 10% in FY 06. Preliminary estimates for FY 06 factored in a 3% increase in the commodity price. These estimates were made prior to the final contract negotiations and actually fell short by 7%. Special approval was then granted by the Board of Regents to allow the affected campuses to generate additional revenue to cover the increased cost through a utility surcharge assessed to the students of the various campuses for the 2006/2007 biennium. The current natural gas contract began in July of 2005 and extends through June of 2007.
- Although a substantial portion of The University of Montana—Missoula's faculty are at or near the age of probable retirement, many retirements have been deferred over the last few years, probably due to the loss of personal asset values. However, a significant (more than 50%) increase in the number of retirements was observed during 2005, as economic conditions have improved. It is still anticipated that a substantial number of faculty retirements will occur over the next five years, at an aggregate cost approaching \$8 million. The University of Montana does have a reserve with a balance of \$1.1 million at June 30, 2005 to help fund a portion of these projected future costs.

The University of Montana
A Component Unit of the State of Montana

Consolidated Statements of Net Assets

At June 30,

	2005	Restated 2004
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 57,171,142	\$ 52,870,136
Investments	8,015,414	3,464,732
Accounts and grants receivable, net	4,093,648	5,017,907
Due from Federal government	8,618,405	7,664,789
Due from primary government	1,006,617	1,132,278
Due from other State of Montana component units	458,222	23,201
Loans to students, net	1,584,127	2,539,048
Inventories	1,731,412	1,695,872
Prepaid expenses and deferred charges	1,620,262	2,006,516
Total current assets	\$ 84,299,249	\$ 76,414,479
Noncurrent Assets		
Restricted cash and cash equivalents	\$ 854,950	\$ 4,727,370
Endowment investments	15,246,253	11,783,947
Other long term investments	5,799,571	8,182,831
Loans to students, net	9,317,013	8,765,975
Bond issuance costs	2,003,906	2,106,445
Capital assets, net	239,743,728	238,949,342
Securities lending collateral	730,270	549,863
Total Noncurrent Assets	\$273,695,691	\$275,065,773
Total Assets	\$357,994,940	\$351,480,252
LIABILITIES		
Current Liabilities		
Accounts payable and accrued liabilities	\$ 18,814,704	\$ 18,420,598
Due to Federal government	23,299	131,302
Due to primary government	1,049,965	630,485
Due to other State of Montana component units	190,423	144,106
Student and other deposits	1,994,765	2,310,446
Deferred revenue	10,599,640	10,166,492
Accrued compensated absences	7,133,956	6,833,716
Current portion of long-term obligations	4,923,326	4,026,145
Total Current Liabilities	\$ 44,730,078	\$ 42,663,290
Noncurrent Liabilities		
Accrued compensated absences	\$ 11,102,128	\$ 10,842,735
Long term obligations	132,381,231	136,796,939
Advances from primary government	5,457,429	5,042,707
Due to Federal Government	9,696,369	9,472,246
Securities lending liability	730,270	549,863
Total Noncurrent Liabilities	\$159,367,427	\$162,704,490
Total Liabilities	\$204,097,505	\$205,367,780
NET ASSETS		
Invested in capital assets, net of related debt	\$105,948,125	\$108,316,821
Restricted for:		
Nonexpendable		
Endowments	13,867,419	10,394,769
Loans	1,816,068	1,760,371
Expendable		
Loans	1,771,860	1,753,508
Scholarships, research, instruction, and other	3,536,658	3,610,038
Unrestricted	26,957,305	20,276,965
Total Net Assets	\$153,897,435	\$146,112,472
Total Liabilities & Net Assets	\$357,994,940	\$351,480,252

The University of Montana

A Component Unit of the State of Montana

Combined Statements of Financial Position - Component Units

At June 30,

	2005	2004
ASSETS		
Cash and cash equivalents	\$ 3,849,161	\$ 3,434,215
Short -term investments	15,489,708	7,718,443
Accrued dividends and interest	540,951	128,514
Investments	132,559,823	121,573,733
Contributions receivable, net	15,877,029	14,737,552
Contracts and notes receivable, net	135,807	6,922
Student loans and other receivables	230,759	470,480
Depreciable assets, net of accumulated depreciation	4,966,512	5,665,779
Other assets	522,108	450,123
Total Assets	\$174,171,858	\$154,185,761
LIABILITIES		
Accounts payable	\$ 458,353	\$ 40,168
Accrued expenses	38,934	45,624
Compensated absences	140,555	125,551
Note payable - bank	572,053	356,500
Note payable - long-term	80,934	522,211
Liabilities to external beneficiaries	2,401,751	2,394,930
Custodial funds	16,721,398	7,872,061
Other liabilities	328,145	328,735
Total Liabilities	\$ 20,742,123	\$ 11,685,780
NET ASSETS		
Net assets - unrestricted	9,559,281	8,877,184
Net assets - Temporarily restricted	56,482,237	46,976,433
Net assets - permanently restricted	87,388,217	86,646,364
Total Net Assets	\$153,429,735	\$142,499,981
Total Liabilities & Net Assets	\$174,171,858	\$154,185,761

The University of Montana

A Component Unit of the State of Montana

Consolidated Statements of Revenues, Expenses and Changes in Net Assets

Years Ended June 30,

	2005	Restated 2004
OPERATING REVENUES:		
Tuition and fees (net of scholarship allowances in 2005 and 2004 of \$18,113,939 and \$17,764,238, respectively; 2005 and 2004 revenues of \$10,108,176 and \$9,547,718, respectively, are pledged)	\$ 83,075,215	\$ 76,601,413
Federal grants and contracts	65,670,978	64,724,689
State and local grants and contracts	7,418,190	5,635,503
Nongovernmental grants and contracts	3,994,410	4,800,632
Indirect cost recoveries	10,422,866	9,698,812
Sales and services of educational departments (2005 and 2004 revenues of \$3,947,188 and \$3,894,755, respectively, are pledged)	12,277,616	10,513,183
Auxiliary enterprises charges:		
Residential life (net of scholarship allowances in 2005 and 2004 of \$1,090,217 and \$633,999, respectively; 2005 and 2004 revenues of \$11,106,268 and \$10,157,309, respectively, are pledged)	11,126,266	10,182,766
Food services (net of scholarship allowances in 2005 and 2004 of \$1,090,216 and \$633,999, respectively; 2005 and 2004 revenues of \$9,357,684 and \$9,069,374, respectively, are pledged)	10,072,945	9,447,463
Other auxiliary revenues (2005 and 2004 revenues of \$8,624,861 and \$8,925,995, respectively, are pledged)	8,879,010	9,932,130
Interest earned on loans to students	29,638	26,019
Other operating revenues	5,209,668	4,581,648
Total operating revenues	\$218,176,802	\$206,144,258
OPERATING EXPENSES:		
Compensation and employee benefits	\$175,849,265	\$168,369,266
Other (note 20)	72,730,894	66,901,057
Scholarships and fellowships	15,696,669	15,166,146
Depreciation and amortization	16,068,885	15,838,362
Total operating expenses	\$280,345,713	\$266,274,831
OPERATING LOSS	\$(62,168,911)	\$(60,130,573)
NON-OPERATING REVENUES (EXPENSES):		
State appropriations	\$ 56,701,381	\$ 58,047,869
Land grant revenues (revenues are pledged)	1,739,645	1,193,305
Private gifts	9,726,707	8,445,343
Investment income (2005 and 2004 revenues of \$738,055 and \$433,065, respectively, are pledged)	2,570,550	1,309,186
Interest expense	(6,599,611)	(7,051,400)
Net non-operating revenues	\$ 64,138,672	\$ 61,944,303
INCOME BEFORE OTHER REVENUES	\$ 1,969,761	\$ 1,813,730
OTHER REVENUES:		
Capital grants and gifts	2,377,702	4,414,321
Additions to permanent endowments	3,437,500	937,500
Total other revenues	5,815,202	5,351,821
Net increase in net assets	\$ 7,784,963	\$ 7,165,551
NET ASSETS:		
Net assets - beginning of year	\$146,112,472	\$138,330,144
Addition to permanent endowments	-	993,051
Adjustment to capital assets	-	(285,582)
Other adjustments	-	(90,692)
Net assets - beginning of year, as adjusted	\$146,112,472	\$138,946,921
Net assets - end of year	\$153,897,435	\$146,112,472

The University of Montana

A Component Unit of the State of Montana

Combined Statement of Activities - Component Units

Year Ended June 30,

	Unrestricted	Temporarily Restricted	Permanently Restricted	2005	2004
REVENUES:					
Contributions	\$ 1,761,042	\$ 15,408,829	\$ 5,490,141	\$ 22,660,012	\$ 17,646,343
Interest and dividend income	293,901	2,947,994	-	3,241,895	2,883,169
Net realized and unrealized gain (loss) on investments	14,860	4,307,135	210,196	4,532,191	9,192,096
Support received from university	382,600	-	-	382,600	394,944
Special events	618,419	325,660	-	944,079	444,743
Other income	15,763	686,692	-	702,455	508,791
Net assets released from restrictions	13,877,528	(13,877,528)	-	-	-
Total revenues	\$ 16,964,113	\$ 9,798,782	\$ 5,700,337	\$ 32,463,232	\$ 31,070,086
EXPENSES:					
Program services					
Academic and institutional	\$ 5,799,927	\$ -	\$ -	\$ 5,799,927	\$ 5,392,347
Capital expenses	2,229,262	-	-	2,229,262	1,429,590
Scholarships and awards	4,303,272	-	-	4,303,272	4,377,405
Total program services	\$ 12,332,461	\$ -	\$ -	\$ 12,332,461	\$ 11,199,342
Operating expenses					
Fundraising efforts	\$ 2,410,363	\$ -	\$ -	\$ 2,410,363	\$ 2,062,697
General and administrative	1,212,998	-	-	1,212,998	1,496,343
Investment management costs	160,425	-	-	160,425	45,694
Other miscellaneous	134,149	-	-	134,149	248,586
Total operating expenses	\$ 3,917,935	\$ -	\$ -	\$ 3,917,935	\$ 3,853,320
Change in net assets before nonoperating items	\$ 713,717	\$ 9,798,782	\$ 5,700,337	\$ 16,212,836	\$ 16,017,424
NON-OPERATING REVENUES (EXPENSES):					
Payments to beneficiaries and change in liabilities due to					
external beneficiaries	(18,694)	(303,233)	-	(321,927)	(334,405)
Adjustments	(12,926)	10,255	(4,958,484)	(4,961,155)	0
Change in net assets	\$ 682,097	\$ 9,505,804	\$ 741,853	\$ 10,929,754	\$ 15,683,019
Net assets, beginning of year	8,877,184	46,976,433	86,646,364	142,499,981	126,816,962
Net assets, end of year	\$ 9,559,281	\$ 56,482,237	\$ 87,388,217	\$ 153,429,735	\$ 142,499,981

The University of Montana

A Component Unit of the State of Montana

Consolidated Statements of Cash Flows

Years Ended June 30,

	2005	Restated 2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Student tuition and fees	\$ 82,713,310	\$ 77,014,910
Federal grants and contracts	66,293,671	65,286,541
State grants and contracts	7,454,744	6,111,902
Nongovernmental grants and contracts	4,014,094	4,836,741
Indirect cost recoveries	10,422,866	9,698,812
Sales and services of educational activities	12,016,912	11,672,004
Auxiliary enterprise charges	30,212,820	30,533,429
Interest earned on loans to students	105,497	116,950
Other operating receipts	5,153,745	4,069,142
Payments to employees for salaries and benefits	(174,511,617)	(168,452,743)
Operating expenses	(72,369,164)	(66,781,611)
Payments for scholarships and fellowships	(15,696,669)	(15,166,146)
Loans made to students	(2,909,678)	(3,882,761)
Loan payments received	3,152,868	2,798,346
Net Cash Used by Operating Activities	\$ (43,946,601)	\$ (42,144,484)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	\$ 56,701,381	\$ 58,047,869
Land Grants	1,739,645	1,193,305
Private Gifts	9,726,708	8,445,344
Additions to permanent endowments	3,437,500	937,500
Net Cash Provided by Noncapital Financing Activities	\$ 71,605,234	\$ 68,624,018
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of investments	\$ (6,925,291)	\$ (11,250,618)
Proceeds from sales of investments	1,460,560	9,906,219
Earnings received on investments	2,405,550	1,533,240
Net Cash (Used for) Provided by Investing Activities	\$ (3,059,181)	\$ 188,841
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Cash paid for capital assets	\$ (13,843,273)	\$ (25,200,926)
Proceeds from the sale of capital assets	212,199	164,288
Proceeds from notes payable and advances from primary government	1,333,876	1,847,837
Principal paid on notes payable, advance from primary government, and capital leases	(1,324,724)	(983,771)
Principal paid on bonds payable	(3,235,000)	(3,720,000)
Principal and premium paid to advance refund revenue bonds	-	(31,339,501)
Proceeds from issuance of revenue bonds	-	42,366,505
Bond issuance costs paid on new issue	-	(613,059)
Interest paid on capital debt and leases	(7,313,944)	(6,986,281)
Net Cash Used by Capital and Related Financing Activities	\$ (24,170,866)	\$ (24,464,908)
Net Increase in Cash and Cash Equivalents	\$ 428,586	\$ 2,203,467
Cash and Cash Equivalents, Beginning of Year	\$ 57,597,506	\$ 55,394,039
Cash and Cash Equivalents, End of Year	\$ 58,026,092	\$ 57,597,506

The University of Montana
A Component Unit of the State of Montana

Consolidated Statements of Cash Flows

Years Ended June 30

(Continued)

2005 Restated
2004

**Reconciliation of Operating Income (Loss) to Net Cash
 Provided (Used By) Operating Activities:**

Operating loss:	\$ (62,168,911)	\$ (60,130,573)
Adjustments to reconcile operating loss to net cash used by operating activities		
Depreciation expense	16,068,885	15,838,362
Other amortization expense	162,832	244,498
Changes in assets and liabilities:		
Accounts receivable	(338,717)	(401,335)
Loans to students	403,883	(841,349)
Inventories	(35,540)	(17,227)
Prepaid expenses and deferred charges	386,254	(362,984)
Accounts payable and accrued expenses	673,489	(99,532)
Deferred revenue	433,149	1,938,999
Student and other deposits	(315,681)	817,635
Due to federal government	224,123	567,505
Compensated absences	559,633	301,517
Net Cash Used by Operating Activities	\$ (43,946,601)	\$ (42,144,484)

**Noncash Investing, Noncapital Financing, and Capital
 and Related Financing Transactions**

Fixed assets acquired by incurring capital lease obligations	\$ (123,996)	\$ (102,230)
Change in fair value of investments recognized as a component of interest income	164,997	(628,361)
Fixed assets acquired from Capital grants and donations	2,236,786	4,523,595

Reconciliation of Cash and Cash Equivalent to the Statement of Net Assets

Cash and cash equivalents classified as current assets	\$ 57,171,142	\$ 52,870,136
Cash and cash equivalents classified as noncurrent assets	854,950	4,727,370
	\$ 58,026,092	\$ 57,597,506

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

THE UNIVERSITY OF MONTANA *A COMPONENT UNIT OF THE STATE OF MONTANA* FOR THE YEARS ENDED JUNE 30, 2005 AND 2004

NOTE 1 – ORGANIZATION, REPORTING ENTITY AND BASIS OF PRESENTATION

▪ ORGANIZATION

The University of Montana (University) is a component unit of the State of Montana (State) with an enrollment of approximately 18,000 students on its four campuses. The State of Montana Board of Regents (Board of Regents) is appointed by the Governor of the State and has oversight responsibility with respect to the University. The State allocates and allots funds to each campus separately and requires that the funds be maintained accordingly.

▪ REPORTING ENTITY

The accompanying consolidated financial statements include all activities of the four campuses of the University, the Forestry Experiment Station and the Montana Bureau of Mines. The four campuses of the University are The University of Montana – Missoula, Montana Tech of The University of Montana, which is located in Butte, The University of Montana – Western, which is located in Dillon, and The University of Montana - Helena College of Technology.

The University adopted GASB No. 39, “Determining Whether Certain Organizations Are Component Units, an Amendment of GASB Statement No. 14” as of and for the year ended June 30, 2004. The statement requires that a legally tax exempt organization should be reported as a component unit of a reporting entity if the economic resources received or held by these organizations are entirely or virtually entirely for the direct benefit of the reporting entity or its component units, and the reporting entity is entitled to, or has the means to otherwise access, a majority of the economic resources received or held by the separate organization. The resources of the separate organization must also be significant to the reporting entity. The University has established a threshold minimum of 1 percent of consolidated net assets or 1 percent of consolidated revenues as an additional requirement for inclusion of an organization as a component unit in its financial statements. In addition, other organizations should be evaluated for inclusion if they are closely related to, or financially integrated with, the reporting entity. All component units and other related organizations will be tested and evaluated on an annual basis for inclusion under GASB No. 39. Accordingly, the University has identified and will present the combined activities of four component units, The University of Montana Foundation, The Montana Tech Foundation, The University of Montana - Western Foundation, and the Montana Grizzly Scholarship Association. For further discussion of accounting for component units, see Consolidated Financial Statements Note 19, “Accounting for Component Units.”

The University is considered a component unit of the State of Montana under GASB No. 14. As such, the financial statements for the University are included as a component part of the State of Montana Basic Financial Statements, which are prepared annually and presented in the Montana Comprehensive Annual Financial Report (CAFR).

The University, as a political subdivision of the State of Montana, is excluded from Federal income taxes under Section 115(1) of the Internal Revenue Code, as amended. Certain activities of the University may be subject to taxation as unrelated business income under Internal Revenue Code Sections 511 to 514.

▪ BASIS OF PRESENTATION

The financial statements have been prepared in accordance with generally accepted accounting principles, as prescribed by the GASB. Under GASB No. 34, “Basic Financial Statements and Management Discussion and Analysis for State and Local Governments” and GASB No. 35, “Basic Financial Statements and Management’s Discussion and Analysis for Public Colleges and Universities,” the University is required to present a Statement of Net Assets, a Statement of Revenues, Expenses and Changes in Net Assets, and a Statement of Cash Flows. All significant intra-entity transactions have been eliminated upon consolidation.

Notes to the Consolidated Financial Statements (continued)

Also, in accordance with GASB Statements No. 39, the combined statement of financial position and statement of activities of the four component units referred to above, are separately presented following the respective University financial statements.

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

▪ BASIS OF ACCOUNTING

For financial reporting purposes, the University is considered a special-purpose government engaged only in business-type activities. Business-type activities are those that are financed in whole or in part by fees charged to external parties for goods or services. Accordingly, the University's consolidated financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred.

The University had the option to apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless FASB conflicts with GASB. The University elected to not apply FASB pronouncements issued after the applicable date.

▪ USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results may differ from these estimates.

▪ CASH EQUIVALENTS

For purposes of the Consolidated Statement of Cash Flows, the University considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. Funds invested in the Short Term Investment Pool (STIP) with the Montana Board of Investments are considered cash equivalents.

▪ INVESTMENTS

The University accounts for its investments at fair value in accordance with GASB No. 31, "Accounting and Financial Reporting for Certain Investments and for External Investment Pools." Investment income is recorded on the accrual basis. All investment income, including changes in unrealized gain (loss) on the carrying value of investments, is reported as a component of investment income.

▪ ACCOUNTS AND GRANTS RECEIVABLE

Accounts receivable consists of tuition and fee charges to students and to auxiliary enterprise services provided to students, faculty and staff. Accounts receivable also includes amounts due from the federal government and local governments, or private sources, in connection with reimbursement of allowable expenditures made pursuant to the University's grants and contracts. Accounts receivable is recorded net of estimated uncollectible amounts.

▪ INVENTORIES

Inventories are comprised of consumable supplies, food items and items held for resale or recharge within the University. The larger inventories are valued using the moving-average method. Other inventories are valued using First In First Out (FIFO) or specific identification methods.

▪ CASH AND SHORT-TERM INVESTMENTS

Cash and investments that are externally restricted to make debt service payments, or to purchase or construct capital or other non-current assets, or by a donor or outside agency prohibiting the expenditure of principal and possibly earnings, are classified as non-current assets in the Consolidated Statement of Net Assets.

▪ CAPITAL ASSETS

Capital assets are stated at cost or fair market value at date of purchase or donation. Renovations to buildings, infrastructure, and land improvements that significantly increase the value or extend the useful life of the asset are

Notes to the Consolidated Financial Statements (continued)

capitalized. Routine repairs and maintenance are charged to operating expense in the year in which the expense was incurred. Buildings, building improvements and land improvements, and infrastructure are capitalized when acquisition costs equal or exceed \$25,000 and \$500,000, respectively. Equipment is capitalized when acquisition costs equal or exceed \$5,000.

Depreciation is computed on a straight-line basis over the estimated useful lives of the respective assets as follows: buildings - 40 years; land improvements and infrastructure - 20 and 40 years, respectively; library books - 8 years; and equipment- 3 to 10 years. Historically, the University has capitalized all artwork subject to applicable capitalization policies at the time of donation or purchase. The University has elected to continue to capitalize artwork subject to the current threshold, but without recording depreciation on those items.

▪ DEFERRED REVENUE

Deferred revenues include amounts received for tuition and fees and certain auxiliary activities prior to the end of the fiscal year but related to the subsequent accounting period. Deferred revenues also include amounts received from grant and contract sponsors that have not yet been earned.

▪ COMPENSATED LEAVE

Eligible University employees earn eight hours sick leave and ten hours annual leave for each month worked. The accrual rate for annual leave increases with length of service. The maximum annual leave that eligible employees may accumulate is two hundred percent of their annual accrual. Sick leave may accumulate without limitation. Twenty-five percent of accumulated sick leave earned after July 1, 1971 and one hundred percent of accumulated annual leave, if not used during employment, is paid upon termination.

▪ NET ASSETS

The University's net assets are categorized as follows:

- **Invested in capital assets, net of related debt** - Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.
- **Restricted, nonexpendable** - Net assets subject to externally imposed stipulations that the University maintain those assets permanently. Such assets include the University's permanent endowment funds.
- **Restricted, expendable** - Net assets whose use by the University is subject to externally imposed stipulations that can be fulfilled by actions of the University pursuant to those stipulations or that expire by the passage of time.
- **Unrestricted** - Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Regents or may otherwise be limited by contractual agreements with outside parties. Substantially all unrestricted net assets are designated for academic and research programs and initiatives, and capital programs.

▪ CLASSIFICATION OF REVENUES

The University has classified its revenues as either operating or non-operating revenues according to the following criteria:

- **Operating revenue** - Operating revenues include activities that have the characteristics of exchange transactions, such as (1) student tuition and fees, net of scholarship discounts and allowances, (2) sales and services of auxiliary enterprises, net of scholarship discounts and allowances, (3) most federal, state and local grants and contracts and federal appropriations, and (4) interest on institutional student loans.
- **Non-operating revenues** - Non-operating revenues include activities that have the characteristics of non-exchange transactions, such as gifts and contributions, and other revenue sources that are defined as non-operating revenues by GASB No. 9, "Reporting Cash Flows of Proprietary and Nonexpendable

Notes to the Consolidated Financial Statements (continued)

Trust Funds and Governmental Entities That Use Proprietary Fund Accounting,” and GASB No. 34, “Basic Financial Statements and Management Discussion and Analysis for State and Local Governments.” Types of revenue sources that fall into this classification are state appropriations and investment income.

▪ SCHOLARSHIP DISCOUNTS AND ALLOWANCES

Student tuition and fee revenues, and certain other revenues from students, are reported net of scholarship discounts and allowances in the Statements of Revenues, Expenses, and Changes in Net Assets. Scholarship discounts and allowances are generated by the difference between the stated charge for goods and services provided by the University, and the amount that is paid by students and/or third parties making payments on the students’ behalf. Certain governmental grants, such as Pell grants, and other federal, state or nongovernmental programs, are recorded as either operating or non-operating revenues in the University’s consolidated financial statements. To the extent that revenues from such programs are used to satisfy tuition and fees and other student charges, the University has recorded a scholarship discount and allowance.

▪ RECLASSIFICATIONS

In order to make certain prior year amounts comparable to the current year presentation on the Statement of Net Assets, approximately \$2.6 million of payroll related liabilities were reclassified from due to federal government to accounts payable and accrued liabilities.

NOTE 3 – PRIOR PERIOD ADJUSTMENTS

In 2005, it was determined that certain transactions that occurred during previous fiscal years were incorrectly reported. The correction of these transactions has resulted in a restatement of the consolidated financial statements for the year ending June 30, 2004.

In the year ended June 30, 2003, the University was awarded an endowment through a federally sponsored endowment award program. The amounts received in the years ending June 30, 2003 and 2004 under the program were not properly reflected as an endowment investment on the University’s consolidated financial statements. This has resulted in a \$2,097,204 restatement of endowment investments on the consolidated Statement of Net Assets at June 30, 2004, and a restatement of \$993,051 to net assets – beginning of year, and other related activity on the consolidated Statement of Revenues, Expenses and Changes in Net Assets and Statement of Cash Flows for that fiscal year.

NOTE 4 – SUBSEQUENT EVENT

On September 15, 2005 The University of Montana issued \$31,095,000 of Series J 2005 Facilities Improvement and refunding Revenue Bonds, with interest ranging from 3.0 percent to 4.5 percent. The proceeds from the issue, together with certain resources of the University, will provide funds to pay and discharge a portion of the Series F Revenue bonds, and finance or refinance, the costs of acquisition, construction, furnishing, equipping, renovation or improvement of certain University facilities.

As part of the transaction, on August 25, 2005, the University also entered into a forward SWAP agreement whereby the remaining portion of the Series F 1999 Revenue Bonds will be refunded in 2010 with the Series K 2010 taxable, variable rate bonds at the \$47,000,000 notional amount of the SWAP. The purpose of the rate swap is to convert the variable rate Series K 2010 Parity Bonds, into a fixed rate obligation. The University received \$2,000,000 which will provide funding for the projects identified in the Series J 2005 Facilities Improvement Revenue bonds. The payment received from the counterparty was consideration for the estimated present value of the fixed rate payable under the agreement upon execution of the SWAP.

Notes to the Consolidated Financial Statements (continued)

NOTE 5 – CASH EQUIVALENTS AND INVESTMENTS

▪ CASH EQUIVALENTS

Cash equivalents consist of cash invested in Guaranteed Investment Contracts (GICs) with AIG Funding Corporation and AMBAC Capital Funding and in the STIP with the Montana Board of Investments. Amounts held in cash equivalents at June 30, 2005 and 2004 were \$35,046,331 and \$31,851,349, respectively. STIP investments are purchased in accordance with the statutorily mandated "Prudent Expert Principle." The STIP portfolio may include asset-backed securities, commercial paper, corporate and government securities, repurchase agreements and variable rate, or floating rate, instruments to provide diversification and a competitive rate of return. Amounts in GIC accounts are unexpended proceeds from the issuance of Facility Improvement Revenue Bonds. Investments in STIP and GICs may be withdrawn by the University on demand, and as such, are classified as cash equivalents.

▪ INVESTMENTS

Investments consisted of the following at June 30, 2005 and 2004:

Security Type	Fair Value		Effective Duration at June 30, 2005*
	2005	2004	
U.S. Government Indirect – Backed	\$ 8,650,289	\$ 8,059,978	.70
U.S. Government Direct – Backed	652,133	1,115,867	.87
Trust Fund Bond Pool (TFBP)	6,013,294	3,932,771	4.91**
Montana Domestic Equity Pool (MDEP)	1,035,112	1,003,254	Not Available
Foundation Pooled Investments	12,447,287	9,060,345	Not Applicable
Certificates of Deposits	263,123	259,295	.93
Total investments	\$ 29,061,238	\$ 23,431,510	
Securities Lending Collateral Investment Pool	\$ 730,270	\$ 549,863	

*See Interest Rate Risk under the Investment Risks disclosure included in this note.

**Effective duration for TFBP is for the entire portfolio.

Investments held by the University at June 30, 2005 and 2004 are described further in the paragraphs below.

U.S. Government Securities

U.S. Government securities consist of bond trustee funds managed by U.S. Bank. The U.S. Government securities portfolio includes Treasury securities or other Federal agency securities, and federal money market accounts. All of the securities were registered under the nominee's name (U.S. Bank) on behalf of the University.

Montana Board of Investments Pools

The University is a participant in certain internal investment pools administered by the Montana Board of Investments (MBOI). MBOI purchases investments for each portfolio in accordance with the statutorily mandated "Prudent Expert Principle." The University was invested in the following internal investment pools at June 30, 2005 and 2004:

Montana Domestic Equity Pool (MDEP)

The MDEP portfolio may include common stock, equity index, preferred stock, convertible equity securities, American Depositary Receipts (ADR's) and equity derivatives. ADR's are receipts issued by a U.S. depositary bank representing shares of a foreign stock or bonds held abroad by the foreign sub-custodian of the American depositary bank. Equity derivatives "derive" their value from other equity instruments such as futures and options.

Trust Funds Bond Pool (TFBP)

The TFBP portfolio includes corporate asset-backed, other corporate, U.S. government mortgage-backed,

Notes to the Consolidated Financial Statements (continued)

and Yankee securities. The TFBP portfolio includes securities classified as corporate, foreign government bonds, municipals, U.S. government direct-backed, U.S. government indirect-backed, and cash equivalents. U.S. government direct-backed securities include direct obligations of the U.S. Treasury and obligations explicitly guaranteed by the U.S. government. U.S. government indirect-backed obligations include U.S. government agency and mortgage-backed securities. U.S. government mortgage-backed securities reflect participation in a pool of residential mortgages.

The TFBP portfolio includes structured financial instruments known as REMICs (Real Estate Mortgage Investment Conduits). REMICs are pass-through vehicles for multiclass mortgage-backed securities.

The University Foundation Pools

This pool consists of endowment funds held in a common investment pool administered by the University of Montana and Montana Tech Foundations.

Certificates of deposit

Certificates of deposit serve as collateral for loans made to students with disabilities for the purchase of specialized equipment necessary to complete their education. The certificate of deposit, including interest earned, is reinvested upon maturity.

Securities lending transactions

Under the provisions of state statutes, the Board of Investments, via a Securities Lending Authorization Agreement, has authorized the custodial bank, State Street Bank and Trust, to lend the Board of Investment's securities to broker-dealers and other entities with a simultaneous agreement to return the collateral for the same securities in the future. During the period the securities are on loan, the Board of Investments receives a fee and the custodial bank must initially receive collateral equal to 102 percent of the market value of the loaned securities and maintain collateral equal to not less than 100 percent of the market value of the loaned security. The Board of Investments retains all rights and risks of ownership during the loan period.

During the years ending June 30, 2005 and 2004, the Board of Investments and the borrowers maintained the right to terminate all securities lending transactions on demand. The cash collateral received on each loan was invested, together with the cash collateral of other qualified-plan lenders, in a collective investment pool, the Securities Lending Quality Trust. The relationship between the average maturities of the investment pool and the Board of Investment's loans was affected by the maturities of the loans made by other plan entities that invested cash collateral in the collective investment pool, which the Board of Investments could not determine. At June 30, 2005 and 2004, the Board of Investments had no credit risk exposure to borrowers.

Investment risks

Effective June 30, 2005, the University implemented the provisions of Governmental Accounting Standards Board (GASB) Statement No. 40 – "Deposit and Investment Risk Disclosures." The financial statement disclosures for the year ended June 30, 2004 have been restated to compare with the financial statement disclosures for the year ended June 30, 2005.

Investment risks are described in the following paragraphs:

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. In accordance with GASB 40, the State of Montana has selected the effective duration method to disclose interest rate risk. Duration is a measure of a debt's exposure to fair value changes from changing interest rates. It uses the present value of the cash flows from the investment, weighting those cash flows as a percentage of the investment's full price. The University does not have a formal investment policy for interest rate risk.

Credit Risk

Credit risk is defined as the risk that an issuer or other counterparty to an investment will not fulfill its

Notes to the Consolidated Financial Statements (continued)

obligation. The University does not have a formal investment policy for credit risk. With the exception of the U.S. government securities, all STIP securities and TFBP fixed income instruments have credit risk as measured by major credit rating services. The MBOI policy requires that STIP securities have the highest investment grade rating in the short term category by at least one Nationally Recognized Statistical Rating Organization (NRSRO). The six NRSRO's include Standard and Poor's, Moody's, Duff and Phelps, Fitch, IBCA and Thompson's Bank Watch. The Board of Investment's policy requires TFBP fixed income investments, at the time of purchase, to be rated an investment grade as defined by Moody's or by Standard & Poor's (S&P) rating services.

U.S. government securities are guaranteed directly or indirectly by the U.S. government. Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit quality.

Custodial Credit Risk

Custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. The University does not have a formal investment policy for custodial credit risk. As of June 30, 2005 and 2004, all STIP, MDEP and TFBP securities were registered in the nominee name for the MBOI and held in the possession of the Board's custodial bank, State Street Bank. According to the STIP Investment Policy, "repurchase agreements require electronic delivery of U.S. Government Treasury collateral, priced at 102 percent of market value, to the designated State of Montana Federal Reserve Bank account." The MDEP's BGI S&P 500 Equity Index Fund A, S&P 400 MidCap Equity Index Fund and the DFA Small Cap Subtrust are registered in the name of the Montana Board of Investments. The TFBP's State Street repurchase agreement was purchased in the name of the State of Montana Board of Investments.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The University does not have a formal policy for concentration of credit risk. Investments issued or explicitly guaranteed by the U.S. government are excluded from the concentration of credit risk requirement. MDEP investments in pooled investments, such as the BGI Equity Index and DFA Small Cap Subtrust investments, are also excluded from this requirement. As of June 30, 2005 and 2004, there were no single issuer investments that exceeded 5% of the MDEP portfolio. According to the TFBP Investment Policy, "with the exception of U.S. government indirect-backed (agency) securities, additional TFBP portfolio purchases will not be made in a credit if the credit risk exceeds 2 percent of the portfolio at the time of purchase". As of June 30, 2005, the TFBP had concentration of credit risk exposure to the Federal Home Loan Mortgage Corp of 8.19%. As of June 30, 2004, there were no single issuer investments that exceeded 5% of the TFBP portfolio.

Land grant earnings

In 1881, The Congress of the United States granted land to the State of Montana for the benefit of the State's universities and colleges. The Enabling Act of 1889 granted 46,563 acres to Missoula, 100,000 acres to Montana Tech and 50,000 acres to Western Montana College. Under provisions of the grants, proceeds from the sale of land and land assets, together with proceeds from the sale of timber, oil royalties and other minerals, must be reinvested, and constitute, along with the balance of unsold land, a perpetual trust fund. The grant is administered as a trust by the State Land Board, which holds title and has the authority to direct, control, lease, exchange and sell these lands. The University, as a beneficiary, does not have title to the assets resulting from the grant, only a right to the earnings generated. The University's share of the trust earnings was \$1,739,645 and \$1,193,305 for the years ended June 30, 2005 and 2004, respectively. These earnings are currently pledged to the Series C 1995, Series E 1998, Series F 1999, Series G 2002, Series H 2003, and Series I 2004 revenue bonds.

The University's land grant assets are not reflected in the consolidated financial statements, but are included as a component of the State of Montana Basic Financial Statements that are prepared annually and presented in the Montana Comprehensive Annual Financial Report (CAFR).

Notes to the Consolidated Financial Statements (continued)

NOTE 6 – INVENTORIES

Inventories consisted of the following at June 30, 2005 and 2004:

	2005	2004
Bookstore	\$ 601,788	\$ 577,815
Food services	104,635	95,506
Facilities services	703,795	466,176
Other	321,194	556,375
	<u>\$ 1,731,412</u>	<u>\$ 1,695,872</u>

NOTE 7 – ACCOUNTS AND GRANTS RECEIVABLE

Accounts Receivable consisted of the following at June 30, 2005 and 2004:

	2005	2004
Student tuition and fees	\$ 1,425,714	\$ 1,134,562
Auxiliary enterprises and other operating activities	1,217,042	1,251,087
Federal and private grants and contracts	1,109,827	2,518,494
Other	594,935	380,714
	<u>4,347,518</u>	<u>5,284,857</u>
Less: allowance for doubtful accounts	253,870	266,950
	<u>\$ 4,093,648</u>	<u>\$ 5,017,907</u>

NOTE 8 – LOANS RECEIVABLE

Student loans made under the Federal Perkins Loan Program constitute the majority of the University's loan receivable balances. Included in non-current liabilities as of June 30, 2005 and 2004 are \$9,696,369 and \$9,472,246, respectively, that would be refundable to the Federal Government should the University choose to cease participation in the Federal Perkins Loan program.

The Federal portion of interest income and loan program expenses is shown as additions to and deductions from the amount due to the Federal government, and not as operating transactions, in the Consolidated Statement of Net Assets.

NOTE 9 – CAPITAL ASSETS

The following tables present the changes in capital assets for the years ended June 30, 2005 and 2004, respectively.

For the year ended June 30, 2005:

	Beginning Balance	Additions	Deletions	Transfers and Other Changes	Ending Balance
Capital assets not being depreciated:					
Land	\$7,000,781	\$ -	\$ -	\$ 125,000	\$ 7,125,781
Capitalized Collections	14,792,998	477,725	-	-	15,270,723
Construction in progress	24,093,859	10,583,647	412,342	(20,899,793)	13,365,371
	<u>45,887,638</u>	<u>11,061,372</u>	<u>412,342</u>	<u>(20,774,793)</u>	<u>35,761,875</u>
Other capital assets:					
Buildings	186,305,169	730,495	-	16,764,786	203,800,450
Building improvements	124,474,478	-	-	1,637,141	126,111,619

Notes to the Consolidated Financial Statements (continued)

Furniture and equipment	47,272,656	3,478,468	3,284,403	367,702	47,834,423
Land improvements	9,368,091	426,310	-	2,425,968	12,220,369
Livestock	18,750	15,447	-	-	34,197
Library materials	46,528,294	1,468,540	-	-	47,996,834
	413,967,438	6,119,260	3,284,403	21,195,597	437,997,892
Less accumulated depreciation for:					
Buildings	82,903,742	4,209,941	-	-	87,113,683
Building improvements	59,063,075	6,551,293	-	-	65,614,368
Furniture and equipment	32,686,712	3,054,539	2,823,120	12,824	32,930,955
Livestock	625	2,978	-	-	3,603
Land improvements	7,605,256	273,871	-	-	7,879,127
Library materials	39,455,107	1,705,260	-	38,440	41,198,807
	221,714,517	15,797,882	2,823,120	51,264	234,740,543
Other capital assets, net	192,252,921	(9,678,622)	461,283	21,144,333	203,257,349
Intangible assets	808,783	186,723	-	(271,002)	724,504
Total capital assets, net	\$ 238,949,342	\$ 1,569,473	\$ 873,625	\$ 98,538	\$ 239,743,728

Capital Asset Summary:

Capital assets not being depreciated	\$ 45,887,638	\$ 11,061,372	\$ 412,342	\$ (20,774,793)	\$ 35,761,875
Other capital and intangible assets	414,776,221	6,305,983	3,284,403	20,924,595	438,722,396
	460,663,859	17,367,355	3,696,745	149,802	474,484,271
Less: accumulated depreciation	221,714,517	15,797,882	2,823,120	51,264	234,740,543
Total capital assets, net	\$ 238,949,342	\$ 1,569,473	\$ 873,625	\$ 98,538	\$ 239,743,728

For the year ended June 30, 2004:

	Beginning Balance	Additions	Deletions	Transfers and Other Changes	Ending Balance
Capital assets not being depreciated:					
Land	\$ 6,935,781	\$ 65,000	\$ -	\$ -	\$ 7,000,781
Capitalized Collections	14,719,484	73,514	-	-	14,792,998
Construction in progress	7,318,693	23,118,786	62,667	(6,280,953)	24,093,859
	28,973,958	23,257,300	62,667	(6,280,953)	45,887,638
Other capital assets:					
Buildings	187,083,209	129,700	-	(907,740)	186,305,169
Building improvements	117,417,880	179,590	-	6,877,008	124,474,478
Furniture and equipment	43,776,847	5,032,368	2,013,068	476,509	47,272,656
Land improvements	9,246,328	-	-	121,763	9,368,091
Livestock	206,420	18,750	206,420	-	18,750
Library materials	44,981,735	1,604,944	58,385	-	46,528,294
	402,712,419	6,965,352	2,277,873	6,567,540	413,967,438
Less accumulated depreciation for:					
Buildings	79,027,493	4,203,574	-	(327,325)	82,903,742
Building improvements	52,141,465	6,201,721	-	719,889	59,063,075
Furniture and equipment	30,822,579	2,957,158	1,129,955	36,930	32,686,712
Livestock	-	625	-	-	625
Land improvements	7,256,209	349,047	-	-	7,605,256
Library materials	37,761,135	1,752,357	58,385	-	39,455,107
	207,008,881	15,464,482	1,188,340	429,494	221,714,517

Notes to the Consolidated Financial Statements (continued)

Other capital assets, net	195,703,538	(8,499,130)	1,089,533	6,138,046	192,252,921
Intangible assets	842,613	480,070	140,020	(373,880)	808,783
Total capital assets, net	<u>\$ 225,520,109</u>	<u>\$ 15,238,240</u>	<u>\$ 1,292,220</u>	<u>\$ (516,787)</u>	<u>\$ 238,949,342</u>

Capital Asset Summary:

Capital assets not being depreciated	\$ 28,973,958	\$ 23,257,300	\$ 62,667	\$ (6,280,953)	\$ 45,887,638
Other capital and intangible assets	403,555,032	7,445,422	2,417,893	6,193,660	414,776,221
	<u>432,528,990</u>	<u>30,702,722</u>	<u>2,480,560</u>	<u>(87,293)</u>	<u>460,663,859</u>
Less: accumulated depreciation	207,008,881	15,464,482	1,188,340	429,494	221,714,517
Total capital assets, net	<u>\$ 225,520,109</u>	<u>\$ 15,238,240</u>	<u>\$ 1,292,220</u>	<u>\$ (516,787)</u>	<u>\$ 238,949,342</u>

NOTE 10 – LONG – TERM LIABILITIES

The following tables present the changes in long-term liabilities for the years ended June 30, 2005 and 2004, respectively:

For the year ended June 30, 2005

	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Bonds, notes and capital leases					
Revenue bonds payable, net	\$ 137,919,669	\$ 213,859	\$ 3,348,188	\$ 134,785,340	\$ 4,340,000
Notes payable	2,076,623	470,000	525,895	2,020,728	380,426
Capital leases payable	826,792	123,996	452,299	498,489	202,900
	<u>140,823,084</u>	<u>807,855</u>	<u>4,326,382</u>	<u>137,304,557</u>	<u>4,923,326</u>
Other long-term liabilities					
Accrued compensated absences	17,676,451	8,045,971	7,486,338	18,236,084	7,133,956
Advances from primary government	5,373,322	863,874	346,525	5,890,671	433,242
Due to Federal Government	9,472,246	224,123	-	9,696,369	-
Securities lending liability	549,863	180,407	-	730,270	-
	<u>33,071,882</u>	<u>9,314,375</u>	<u>7,832,863</u>	<u>34,553,394</u>	<u>7,567,198</u>
Total long-term liabilities	<u>\$ 173,894,966</u>	<u>\$ 10,122,230</u>	<u>\$ 12,159,245</u>	<u>\$ 171,857,951</u>	<u>\$ 12,490,524</u>

For the year ended June 30, 2004

	Beginning Balance	Additions	Deductions	Ending Balance	Current Portion
Bonds, notes and capital leases					
Revenue bonds payable, net	\$ 131,809,848	\$ 38,468,485	\$ 32,358,664	\$ 137,919,669	\$ 3,235,000
Notes payable	239,095	2,478,826	641,298	2,076,623	415,014
Capital leases payable	1,251,618	102,230	527,056	826,792	376,131
	<u>133,300,561</u>	<u>41,049,541</u>	<u>33,527,018</u>	<u>140,823,084</u>	<u>4,026,145</u>
Other long-term liabilities					
Accrued compensated absences	17,374,934	7,265,095	6,963,578	17,676,451	6,833,716
Advances from primary government	5,039,729	780,000	446,407	5,373,322	330,615
Due to Federal Government	8,904,742	567,504	-	9,472,246	-
Securities lending liability	774,467	-	224,604	549,863	-
	<u>32,093,872</u>	<u>8,612,599</u>	<u>7,634,589</u>	<u>33,071,882</u>	<u>7,164,331</u>
Total long-term liabilities	<u>\$ 165,394,433</u>	<u>\$ 49,662,140</u>	<u>\$ 41,161,607</u>	<u>\$ 173,894,966</u>	<u>\$ 11,190,476</u>

Notes to the Consolidated Financial Statements (continued)

▪ LONG-TERM LIABILITIES

Long-term liabilities include:

- capital lease obligations, principal amounts of bonds payable, revenue bonds payable, and notes payable with contractual maturities greater than one year;
- estimated amounts for accrued compensated absences and other liabilities that will not be paid within the next fiscal year; and
- other liabilities that, although payable within one year, are to be paid from funds that are classified as non-current assets.

Capital Leases

The University has future minimum lease commitments for capital lease obligations consisting of the following at June 30, 2005:

<u>Fiscal Year</u>	<u>Total</u>
2006	\$ 241,280
2007	213,608
2008	69,652
2009	39,288
2010	815
Minimum lease payments	\$ 564,643
Less: Amount representing interest	66,154
Present value of net minimum lease payments	<u>\$ 498,489</u>

NOTE 11 – REVENUE BONDS

Revenue bonds were issued pursuant to an Indenture of Trust between the Board of Regents of Higher Education for the State of Montana (on behalf of The University of Montana) and U. S. Bank Trust National Association MT. The bonds are secured by a first lien on the combined pledged revenues of the four campuses of The University of Montana. The pledged revenues earned at each campus are cross-pledged among all campuses of The University of Montana. Bonds payable recorded by each campus reflect the liability associated with the bond proceeds deposited into the accounts of that campus and do not necessarily mean that the debt service payments on that liability will be made by that campus.

The total aggregate principal amount originally issued pursuant to the Indenture of Trust and the various supplements to the Indenture for all campuses of The University of Montana at June 30, 2005 and 2004, was \$148,981,780 for both fiscal years. The combined principal amount outstanding at June 30, 2005 and 2004 was \$136,595,000 and \$139,830,000, respectively.

Series C 1995

On December 14, 1995, The University of Montana issued \$34,406,784 of Series C 1995 Revenue Bonds, with interest ranging from 3.80 percent to 5.75 percent. In fiscal year 2000, the Series F 1999 Revenue Bonds issuance advance refunded a portion of Series C 1995 revenue bonds.

Series E 1998

On June 26, 1998, The University of Montana issued \$10,670,000 of Series E 1998 Revenue Bonds, with interest ranging from 3.90 percent to 5.00 percent. The proceeds from the issue provided funds for the acquisition, construction, repair, replacement, renovation and improvement of certain facilities and properties.

Series F 1999

On November 12, 1999, The University of Montana issued \$69,240,000 of Series F 1999 Revenue Bonds, with interest rates ranging from 3.80 percent to 6.00 percent. The proceeds from the issue were used for the purpose of

Notes to the Consolidated Financial Statements (continued)

restructuring Series B, C and D Facilities Improvement Revenue Bonds, and for the acquisition, construction, remodeling, improvement and equipping certain facilities and properties at The University of Montana.

The University of Montana recorded \$58,205,000 of the Series F 1999 Revenue Bonds to advance refund \$58,609,189 of outstanding Series B, C and D Facilities Improvements Revenue Bonds with average interest rates ranging from 4.30 percent to 6.65 percent. The bonds are considered legally defeased and as a result, the liability for those bonds is no longer recorded in the consolidated financial statements.

Included in the Series F issuance was \$10,650,000 for construction of a new recreation facility at The University of Montana - Missoula. The students of the University voted to assess a student fee to fund a portion of the debt service on the \$10,650,000. The remainder of the debt service will be paid by fees charged faculty and staff and from other projected sources of revenue.

Series G 2002

On October 18, 2002, The University of Montana issued \$18,900,000 of Series G Facilities Improvement Revenue Bonds, with interest ranging from 3.00 percent to 4.65 percent. The proceeds from the issue provided funds for the acquisition, construction, furnishing and equipping of certain student housing facilities on the Missoula campus.

Series H 2003

In April 2003, The University of Montana issued \$1,015,000 of Series H Facilities Improvement Revenue Bonds, with interest at 2.70 percent. The proceeds from the issue provided funds for the Washington Grizzly Stadium expansion on the Missoula campus.

Series I 2004

In April 2004, The University of Montana issued \$40,490,000 of Series I Refunding and Facilities Improvement Revenue Bonds, with interest ranging from 3.00 percent to 4.75 percent. The proceeds from the issue paid and discharged \$30,540,000 of Series A 1993, Revenue Bonds. The issuance also provided \$7,000,000 towards future expansion of the Skaggs Building and \$2,950,000 for deferred maintenance on the Missoula campus.

Defeased Bonds

The University has defeased certain bond issues by placing proceeds of new bonds in an irrevocable trust. The proceeds, together with interest earned thereon, will be sufficient for future debt service payments on the refunded issues. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the University's consolidated financial statements. As of June 30, 2005 and 2004, \$47,236,073 and \$49,351,963, respectively, of bonds outstanding were considered defeased.

Revenue Bonds Payable

As of June 30, 2005 annual principal payments are as follows:

Series C 1995 (Partial)

Fiscal Year	Interest Rate	Principal
2006	5.25 – 5.375%	\$ 405,000
2007	5.375%	425,000
2008	5.00 – 5.375%	450,000
2009	5.00 – 5.10%	475,000
2010	5.10 – 5.25%	495,000
2011	5.10 – 5.25%	525,000
		<u>\$ 2,775,000</u>

Series E 1998

Fiscal Year	Interest Rate	Principal
2006	4.30 – 4.35%	\$ 595,000
2007	4.35 – 4.40%	360,000
2008	4.40 – 4.45%	375,000
2009	4.45 – 4.50%	405,000

Notes to the Consolidated Financial Statements (continued)

2010	4.50 - 4.60%	310,000
2011-2015	4.60 - 5.00%	2,385,000
2016-2020	5.00%	2,835,000
2021	5.00%	540,000
		<u>7,805,000</u>
Less unamortized discount:		<u>25,504</u>
		<u>\$ 7,779,496</u>

Series F 1999

<u>Fiscal Year</u>	<u>Interest Rate</u>	<u>Principal</u>
2006	4.70 - 4.80%	\$ 285,000
2007	4.80 - 4.90%	545,000
2008	4.90 - 5.00%	555,000
2009	5.00 - 5.10%	610,000
2010	5.10 - 5.20%	800,000
2011-2015	5.20 - 5.75%	6,375,000
2016-2020	5.75 - 6.00%	26,165,000
2021-2025	5.75 - 5.80%	31,685,000
2026	5.80%	760,000
		<u>67,780,000</u>
Less unamortized discount:		<u>1,049,594</u>
		<u>\$ 66,730,406</u>

Series G 2002

<u>Fiscal Year</u>	<u>Interest Rate</u>	<u>Principal</u>
2006	3.00%	\$ 445,000
2007	3.00%	455,000
2008	3.00%	465,000
2009	3.00%	480,000
2010	3.00 - 3.15%	420,000
2011-2015	3.15 - 3.90%	2,305,000
2016-2020	3.90 - 4.40%	2,790,000
2021-2025	4.40 - 4.65%	3,460,000
2026-2030	4.65%	4,360,000
2031-2033	4.65%	3,135,000
		<u>18,315,000</u>
Less unamortized discount:		<u>45,036</u>
		<u>\$ 18,269,964</u>

Series H 2003

<u>Fiscal Year</u>	<u>Interest Rate</u>	<u>Principal</u>
2006	2.70%	\$ 200,000
2007	2.70%	200,000
2008	2.70%	215,000
		<u>\$ 615,000</u>

Series I 2004

<u>Fiscal Year</u>	<u>Interest Rate</u>	<u>Principal</u>
2006	3.00%	\$ 2,410,000
2007	3.00%	2,540,000
2008	3.00%	2,620,000
2009	3.00 - 3.50%	2,660,000
2010	3.50%	2,710,000
2011-2015	3.50 - 4.75%	15,240,000
2016-2020	3.75 - 4.375%	2,155,000
2021-2025	4.375 - 4.50%	6,790,000

Notes to the Consolidated Financial Statements (continued)

2026-2030	4.50%	2,180,000
		\$ 39,305,000
Add net unamortized premium:		986,276
		<u>\$ 40,291,276</u>

Revenue Bond Payable Summary:

Total revenue bonds outstanding	\$ 136,595,000
Less: Net unamortized discount	133,858
Unamortized loss on advance refunding	1,675,802
Revenue bonds payable, net	<u>\$ 134,785,340</u>

The scheduled maturities of the revenue bonds payable are as follows:

Fiscal Year	Principal	Interest	Total Payment
2006	\$ 4,340,000	\$ 6,693,855	\$ 11,033,855
2007	4,525,000	6,540,335	11,065,335
2008	4,680,000	6,379,267	11,059,267
2009	4,630,000	6,212,589	10,842,589
2010	4,735,000	6,033,958	10,768,958
2011-2015	26,830,000	26,970,949	53,800,949
2016-2020	33,945,000	19,858,111	53,803,111
2021-2025	42,475,000	9,290,836	51,765,836
2026-2030	7,300,000	1,702,642	9,002,642
2031-2033	3,135,000	296,206	3,431,206
	<u>\$ 136,595,000</u>	<u>\$ 89,978,748</u>	<u>\$ 226,573,748</u>

NOTE 12 – NOTES PAYABLE

Notes payable at June 30, 2005 consisted of the following:

Description	Interest Rate	Maturity Date	Principal Outstanding	Current Maturities
First Interstate Bank	7.00%	15-Oct-15	\$ 212,929	\$ 14,982
Ames Construction, Inc.	3.085%	01-Nov-08	1,337,797	325,772
Wells Fargo Bank	4.48%	1-May-15	470,000	39,672
			<u>\$ 2,020,726</u>	<u>\$ 380,426</u>

The scheduled maturities of the notes payable are as follows:

Fiscal Year	Principal	Interest	Total Payment
2006	\$ 380,426	\$ 67,792	\$ 448,218
2007	387,096	45,710	432,806
2008	418,470	41,633	460,103
2009	382,995	26,091	409,086
2010	65,233	22,786	88,019
2011-2015	382,751	57,496	440,247
2016	3,755	36	3,791
	<u>\$ 2,020,726</u>	<u>\$ 261,544</u>	<u>\$ 2,282,270</u>

Notes to the Consolidated Financial Statements (continued)

NOTE 13 – COMPENSATED LEAVE

Employee compensated absences are accrued at year-end for consolidated financial statement purposes. The liability and expense incurred are recorded at year-end as accrued compensated absences in the Statements of Net Assets, and as a component of compensation and benefit expense in the Statements of Revenues, Expenses, and Changes in Net Assets.

NOTE 14 – ADVANCES FROM PRIMARY GOVERNMENT

Advances from the primary government are received through the Intercap Program offered through the Montana Board of Investments. The program lends money to State agencies, including the Montana University System, for the purpose of financing or refinancing the acquisition and installation of equipment or personal and real property and infrastructure improvements.

The Montana Science and Technology Alliance (MSTA) loan originates from a loan that was originally issued in 1994 and has a remaining term of 57 years. The interest rates are variable and are adjusted annually.

Advances from Primary Government at June 30, 2005, are as follows:

Description	Interest Rate	Maturity Date	Principal Outstanding
Intercap – Network Engineering	Variable	15-Feb-07	\$ 59,490
Intercap – Weight Room Expansion	Variable	15-Feb-09	108,243
Intercap – Real Estate	Variable	15-Feb-12	65,783
Intercap – KUFM TV	Variable	15-Feb-07	113,892
Intercap – Lubrecht Forest	Variable	15-Aug-08	72,163
Intercap – Intercollegiate Athletics	Variable	15-Feb-10	265,732
Intercap – Facility Services	Variable	15-Feb-06	30,328
Intercap – Dining Services	Variable	15-Aug-08	17,617
Intercap – Forestry	Variable	15-Aug-14	955,602
Intercap – Adams Center	Variable	15-Feb-08	60,783
Intercap – Facility Services	Variable	15-Feb-10	86,536
Intercap – Public Safety	Variable	15-Feb-13	406,370
Intercap – Microwave Network	Variable	15-Aug-11	65,375
MSTA loan – Research Offices	Variable	30-June-61	3,582,757
			5,890,671
Less Current Maturities			433,242
			<u>\$ 5,457,429</u>

The scheduled maturities of the Intercap loans and MSTA loan are as follows:

Fiscal Year	Principal	Interest	Total Payment
2006	\$ 433,242	\$ 172,557	\$ 605,799
2007	417,325	156,696	574,021
2008	339,474	142,248	481,722
2009	315,129	129,964	445,093
2010	279,592	119,191	398,783
2011-2015	865,087	477,150	1,342,237
2016-2020	205,321	394,679	600,000
2021-2025	232,272	367,728	600,000
2026-2030	262,761	337,239	600,000
2031-2035	297,252	302,748	600,000
2036-2040	336,271	263,729	600,000

Notes to the Consolidated Financial Statements (continued)

2041-2045	380,412	219,588	600,000
2046-2050	430,346	169,654	600,000
2051-2055	486,836	113,164	600,000
2056-2060	550,740	49,260	600,000
2061-2062	58,611	1,464	60,075
	\$ 5,890,671	\$ 3,417,059	\$ 9,307,730

NOTE 15 – RETIREMENT PLANS

Full-time employees of the University are members of the Public Employees’ Retirement System (PERS), Game Wardens’ & Peace Officers’ Retirement System (GWPORS), Teachers’ Retirement System (TRS) or the Optional Retirement Program (ORP) as described below. Only faculty and administrators with contracts under the authority of the Board of Regents are enrolled under TRS or ORP. Beginning July 1, 1993, state legislation required all new faculty and administrators with contracts under the authority of the Board of Regents to enroll in ORP.

PERS, GWPORS and TRS

PERS, GWPORS and TRS are statewide, cost-sharing, multiple-employer defined benefit retirement plans. The plans are established under State law and are administered by the State of Montana. The plans provide retirement, disability, and death benefits to plan members and beneficiaries. PERS, a mandatory system established by the State in 1945, provides retirement services to substantially all public employees. GWPORS, established in 1963, provides retirement benefits for all persons employed as a game warden, warden supervisory personnel, and state police officers not eligible to join the Sheriffs’ Retirement System, Highway Patrol Officers’ Retirement System, and Municipal Police Officers’ Retirement System. TRS, established in 1937, provides retirement services to all persons employed as teachers or professional staff of any public elementary or secondary school, or unit of the University System.

Contribution rates for the plans are required and determined by State law. The contribution rates for 2005 and 2004 expressed as a percentage of covered payrolls were as follows:

	2005			2004		
	Covered Payroll	Employee	Employer	Covered Payroll	Employee	Employer
PERS	\$ 34,348,500	6.90%	6.90%	\$33,433,397	6.90%	6.90%
GWPORS	\$ 425,938	10.50%	9.48%	\$ 454,543	10.60%	9.00%
TRS	\$ 22,555,691	8.32%	7.47%	\$23,664,685	8.32%	7.47%

The amounts contributed to the plan during years ending June 30, 2005, 2004, and 2003 were equal to the required contribution each year. The amounts contributed were as follows:

	Year ending June 30,		
	2005	2004	2003
<u>PERS</u>			
Employer	\$ 2,370,217	\$ 2,307,287	\$ 2,440,236
Employee	\$ 2,370,043	\$ 2,306,542	\$ 2,439,770
<u>GWPORS</u>			
Employer	\$ 40,373	\$ 40,909	\$ 37,579
Employee	\$ 44,779	\$ 48,000	\$ 44,093
<u>TRS</u>			
Employer	\$ 1,685,188	\$ 1,767,774	\$ 1,863,593
Employee	\$ 2,201,136	\$ 2,100,459	\$ 2,074,460

Notes to the Consolidated Financial Statements (continued)

The plans issue publicly available annual reports that include financial statements and required supplemental information. The reports may be obtained from the following:

Public Employees' Retirement Administration
P.O. Box 200131
100 North Park, Suite 220
Helena, Montana 59620-0131
Phone: (406) 444-3154

Teachers' Retirement Division
P.O. Box 200139
1500 Sixth Avenue
Helena, MT 59620-0139
Phone: (406) 444-3134

ORP

ORP was established in 1988 and is underwritten by the Teachers' Insurance and Annuity Association - College Retirement Equities Fund (TIAA-CREF). The ORP is a defined-contribution plan. Until July 1, 2003, only faculty and staff with contracts under the authority of the Board of Regents were eligible to participate. The plan was changed, effective July 1, 2003, to allow all staff to participate in the ORP. Contribution rates for the plan are required and determined by State law. The University's contributions were equal to the required contribution. The benefits at retirement depend upon the amount of contributions, amounts of investment gains and losses and the employee's life expectancy at retirement. Under the ORP, each employee enters into an individual contract with TIAA-CREF. The University records employee/employer contributions and remits monies to TIAA-CREF. Individuals vest immediately in the employer portion of retirement contributions.

Contributions to ORP (TIAA-CREF) were as follows:

	Year ending June 30,	
	2005	2004
<u>FACULTY</u>		
Covered Payroll	\$50,515,235	\$47,841,418
Employer Contributions	\$2,503,535	\$2,371,021
Percent of Covered Payroll	4.956%	4.956%
Employee Contributions	\$3,558,187	\$3,370,302
Percent of Covered Payroll	7.043%	7.046%
<u>STAFF</u>		
Covered Payroll	\$6,730,564	\$6,673,423
Employer Contributions	\$302,202	\$299,637
Percent of Covered Payroll	4.49%	4.49%
Employee Contributions	\$463,606	\$460,441
Percent of Covered Payroll	6.90%	6.90%

For the years ended June 30, 2005 and 2004, \$2,040,815 and \$1,932,793, respectively, or 4.04 percent, was contributed to TRS from ORP faculty employer contributions to amortize past service unfunded liability in accordance with state law. In addition, \$161,404 and 160,829, respectively, or 2.41% was contributed to PERS from ORP staff employer contributions to amortize past service unfunded liability in accordance with state law.

Annual reports that include financial statements and required supplemental information on the plan are available from:

TIAA-CREF
730 Third Avenue
New York, New York 10017-3206
Phone: 1-800-842-2733

Notes to the Consolidated Financial Statements (continued)

NOTE 16 – RISK MANAGEMENT

Due to the diverse risk exposure of the University and its constituent agencies, the insurance portfolio contains a comprehensive variety of coverage. Montana statutes, 2-9-101 through 305, MCA and ARM 2-2-298, require participation of all state agencies in the self-insurance plan established by the Montana Department of Administration, Risk Management and Tort Defense Division (RMTDD). The self-insurance program includes coverage for commercial general liability, auto liability, professional liability, and errors and omissions exposures. The RMTDD provides coverage, above self-insured retentions, by purchasing other commercial coverage through the State's broker, Willis of Seattle, for excess liability, property, crime, fidelity, boiler and machinery, fine arts, aircraft-liability and hull coverage. The RMTDD also supplies other commercial insurance coverage for specific risk exposures on an as-needed basis such as the Volunteer Accident and Health, Dismemberment and Accidental Death coverage obtained for all units of the Montana University System. In addition to these basic policies, the University has established guidelines in risk assessment, risk avoidance, risk acceptance and risk transfer.

The Tort Claims Act of the State of Montana, 2-9-102 MCA, "provides that Governmental entities are liable for its torts and of those of its employees acting within the course and scope of their employment or duties whether arising out of a governmental or proprietary function, except as specifically provided by the Legislature". Accordingly, 2-9-305 MCA requires that the State "provide for the immunization, defense and indemnification of its public officers and employees civilly sued for their actions taken within the course and scope of their employment". The University also has commercial coverage for other risk exposures that are not covered by the State's self-insurance program.

Buildings and contents – are insured for replacement value. For each loss covered by the State's self-insurance program and commercial coverage, the University has a \$1,000 per occurrence retention.

General liability and tort claim coverage – include comprehensive general liability, auto liability, personal injury liability, officer's and director's liability, professional liability, aircraft liability, watercraft liability, leased vehicles and equipment liability, and are provided for by the University's participation in the State's self-insurance program.

Self-Funded Programs – The University's health care program is self-funded, and is provided through participation in the Montana University System (MUS) Inter-unit Benefits Program. The MUS program is funded on an actuarial basis and the University believes that sufficient reserves exist to pay run-off claims related to prior years, and that the premiums and University contributions are sufficient to pay current and future claims.

Effective July 1, 2003 (for fiscal year 2004), the University's workers' compensation program became self-funded and is provided through membership in the MUS Self Insured Workers' Compensation Program. In fiscal year 2003 the University's workers' compensation coverage was provided for through participation in the State's Compensation Insurance Fund. The MUS self-funded program is funded on an actuarial basis and is administered by a third party, currently Missoula County. The MUS program incorporates a self-insured retention of \$500,000 per claim and excess commercial coverage to statutory limits. Employer's liability is provided with a \$500,000 retention and an excess insurance limit of \$1,000,000. The University provides periodic disbursements to the administrator for claims paid and administrative expenses. Benefits provided are prescribed by state law and include biweekly payments for temporary loss of wages as well as qualifying permanent partial and permanent total disability. Medical and indemnity benefits are statutorily prescribed for qualifying job-related injuries or illnesses.

NOTE 17 – COMMITMENTS AND CONTINGENCIES

At June 30, 2005, the University had the following outstanding commitments under major capital and maintenance projects:

Project	Budget Authorization	Total Expenditures through June 2005	Funding Source
South Campus University Housing	\$ 16,668,000	\$ 16,668,000	2002 Series G Revenue Bonds
Campus Network Infrastructure	562,863	562,863	2002 Series G Revenue Bonds

Notes to the Consolidated Financial Statements (continued)

Skaggs Building Addition	14,000,000	1,442,798	2004 Series I Revenue Bonds, Donations, Grants
Campus Deferred Maintenance	1,500,000	1,151,265	2004 Series I Revenue Bonds
Chemistry Building Renovation	825,000	804,179	General Operating and Plant Funds, Donations
Lewis and Clark Transfer Station	1,006,370	1,006,370	County, Auxiliary Operations
Research Lab Facility	1,888,620	1,888,620	Intercap Loan, Designated and General Operating Funds and Donations
Journalism Building	12,050,000	750,783	Intercap Loan, Donations and Plant Fund
Science Complex Rm. 342	145,700	145,700	Federal Grant
Renovate Liberal Arts	101,586	52,118	Equipment Fees, General Operating and Donations
Upgrade Boiler Controls	275,000	248,265	General Operating and Plant Funds
McGill Hall Renovation (372738)	1,265,000	1,223,931	Donations
Clark Fork Park-n-Ride (371557)	600,000	-	Intercap Loan and Auxiliary Operations
COT Futures Park	100,000	91,200	Research & Development
Science Complex Network Maintenance	125,000	25,713	Technology Fees
Petroleum Bldg Window Replacement	300,000	132,935	Plant Fund
	<u>\$ 51,413,139</u>	<u>\$ 26,194,740</u>	

Operating leases – The University has commitments under non-cancelable operating leases as follows:

Payable during the year ending June 30,	Total
2006	\$ 137,617
2007	63,695
2008	32,891
2009	6,773
	<u>\$ 240,976</u>

The University is a defendant in several legal actions. While the outcome cannot be determined at this time, management is of the opinion that the liability, if any, from these actions will not have a material effect on the University's financial position.

In the normal course of operations, the University receives grants and other forms of reimbursement from various Federal and State agencies. These funds are subject to review and audit by cognizant agencies. The University does not expect any material adjustments or repayments to result from such audits.

Although the University is exempt from Federal income tax as an instrumentality of the State of Montana, certain income may be considered unrelated business income by the Internal Revenue Service (IRS). The Montana University System files appropriate tax returns with the IRS to report such income. Because the tax liability for the System as a whole is not material, no provision is recorded in the accompanying consolidated financial statements.

NOTE 18– RELATED PARTIES

The University of Montana is a component unit of the State of Montana. The University's consolidated financial statements and the combined financial statements of its component units include only the activities, funds and accounts of the University and the component units. Private nonprofit organizations with relations to the University include The University of Montana Alumni Association, the Montana Technology Enterprise Center (MonTEC), the Montana Tech Booster Club, the Montana Tech Alumni Association and the University of Montana – Western Booster Club.

The associations and booster clubs operate exclusively for the purposes of encouraging, promoting and supporting educational programs, research, scholarly pursuits and athletics at, or in connection with the University. For the years ended June 30, 2005 and 2004, the following was transferred from or expended by booster clubs for

Notes to the Consolidated Financial Statements (continued)

scholarships and construction projects: from the Montana Tech Booster Club \$65,539 and \$61,058, respectively; and \$52,345 and \$26,380, respectively from the University of Montana – Western Booster Club. In exchange, the University provides the associations and booster clubs with office space, staff and some related office expenses.

MonTEC was established as a nonprofit 501 (c) 3 corporation in fiscal year 2001 as a result of an agreement between the University and the Missoula Area Economic Development Foundation (MAEDF). MonTEC provides low cost lease space and business consulting to local “start-up” companies. The corporation’s board of directors is comprised equally of members appointed by MAEDF and the University.

NOTE 19 - ACCOUNTING FOR COMPONENT UNITS

The entities included as component units in the financial statements are nonprofit, tax exempt organizations operating exclusively for the purposes of encouraging, promoting and supporting educational programs, research, scholarly pursuits and athletics at, or in connection with the University. Although the University does not control the timing or amount of receipts from these entities, the majority of the revenues or income that the entities hold and invest is restricted to the activities of the University by donors. The entities included as component units in the financial statements are The University of Montana Foundation, The Montana Tech Foundation, The University of Montana – Western Foundation and The Montana Grizzly Scholarship Association.

For the fiscal years ended June 30, 2005 and 2004, the following was transferred to or expended for scholarships, academic or institutional support or capital expenses by the University foundations: \$9,171,475 and \$8,298,485, respectively with The University of Montana Foundation (406-243-2593), \$1,384,656 and \$1,187,458, respectively with the Montana Tech Foundation (406-496-4532); and \$194,937 and \$220,135, respectively with The University of Montana-Western Foundation (406-683-7305). In addition, \$1,032,507 and \$878,000 was transferred from the Montana Grizzly Scholarship Association (406-243-6485) for the fiscal years ended June 30, 2005 and 2004, respectively. In exchange, the University provides the foundations with office space and an annually contracted fee, and the association with office space, staff and some related office expenses. For the fiscal years ended June 30, 2005 and 2004, the University provided \$392,600 and \$404,944, respectively, to its Foundations, which included payments for contracted services and capital campaign support.

Condensed financial information for each of the University’s component units is presented below. The information for The University of Montana – Western Foundation is as of December 31, for the years presented. The financial information for all the other component units is as of June 30, for the years presented.

STATEMENT OF FINANCIAL POSITION June 30, 2005 and December 31, 2004

	University of Montana Foundation *	Montana Tech Foundation *	University of Montana – Western Foundation **	Montana Grizzly Scholarship Association*	Total
ASSETS					
Cash and investments	\$ 127,148,400	\$ 20,637,712	\$ 3,617,368	\$ 1,036,163	\$ 152,439,643
Amounts due from institution or other component units	-	-	-	41,000	41,000
Other receivables, net of allowances	15,235,565	884,387	2,970	79,673	16,202,595
Fixed assets, net of depreciation	4,796,943	162,321	-	7,248	4,966,512
Other assets	401,203	4,284	-	116,621	522,108
	\$ 147,582,111	\$ 21,688,704	\$ 3,620,338	\$ 1,280,705	\$ 174,171,858
LIABILITIES AND NET ASSETS					
Current liabilities associated with operations	\$ 462,250	\$ 30,110	\$ 584	\$ 4,343	\$ 497,287
Note payable – other	100,000	145,214	40,000	256,931	542,145
Note payable – long-term	358,053	-	-	-	358,053

Notes to the Consolidated Financial Statements (continued)

Long-term liabilities - other	140,555	80,934	-	-	221,489
Liabilities to external beneficiaries	2,401,751	-	-	-	2,401,751
Custodial funds	16,721,398	-	-	-	16,721,398
	<u>20,184,007</u>	<u>256,258</u>	<u>40,584</u>	<u>261,274</u>	<u>20,742,123</u>
Net assets – unrestricted	6,092,985	2,936,944	241,644	287,708	9,559,281
Net assets – restricted	121,305,119	18,495,502	3,338,110	731,723	143,870,454
	<u>127,398,104</u>	<u>21,432,446</u>	<u>3,579,754</u>	<u>1,019,431</u>	<u>153,429,735</u>
	<u>\$ 147,582,111</u>	<u>\$ 21,688,704</u>	<u>\$ 3,620,338</u>	<u>\$ 1,280,705</u>	<u>\$ 174,171,858</u>

* For the year ended June 30, 2005

** For the year ended December 31, 2004

STATEMENT OF FINANCIAL POSITION June 30, 2004 and December 31, 2003

	University of Montana Foundation *	Montana Tech Foundation *	University of Montana – Western Foundation **	Montana Grizzly Scholarship Association*	Total
ASSETS					
Cash and investments	\$ 110,585,573	\$ 18,153,453	\$ 3,389,114	\$ 726,765	\$ 132,854,905
Amounts due from institution or other component units	-	-	-	216,500	216,500
Other receivables, net of allowances	13,696,089	1,248,857	1,600	51,908	14,998,454
Fixed assets, net of depreciation	5,575,588	86,709	-	3,482	5,665,779
Other assets	414,788	7,812	-	27,523	450,123
	<u>\$ 130,272,038</u>	<u>\$ 19,496,831</u>	<u>\$ 3,390,714</u>	<u>\$ 1,026,178</u>	<u>\$ 154,185,761</u>
LIABILITIES AND NET ASSETS					
Current liabilities associated with operations	\$ 43,894	\$ 24,001	\$ 5,771	\$ 12,126	\$ 85,792
Note payable – other	100,000	160,107	40,000	385,128	685,235
Note payable – long-term	408,557	-	-	-	408,557
Long-term liabilities - other	125,551	113,654	-	-	239,205
Liabilities to external beneficiaries	2,394,930	-	-	-	2,394,930
Custodial funds	7,872,061	-	-	-	7,872,061
	<u>10,944,993</u>	<u>297,762</u>	<u>45,771</u>	<u>397,254</u>	<u>11,685,780</u>
Net assets – unrestricted	5,670,324	2,906,647	236,271	63,942	8,877,184
Net assets – restricted	113,656,721	16,292,422	3,108,672	564,982	133,622,797
	<u>119,327,045</u>	<u>19,199,069</u>	<u>3,344,943</u>	<u>628,924</u>	<u>142,499,981</u>
	<u>\$ 130,272,038</u>	<u>\$ 19,496,831</u>	<u>\$ 3,390,714</u>	<u>\$ 1,026,178</u>	<u>\$ 154,185,761</u>

* For the year ended June 30, 2004

** For the year ended December 31, 2003

STATEMENT OF ACTIVITY For the year ended June 30, 2005 and December 31, 2004

	University of Montana Foundation *	Montana Tech Foundation *	University of Montana – Western Foundation **	Montana Grizzly Scholarship Association *	Total
REVENUES					
Contributions	\$ 18,318,808	\$ 2,573,871	\$ 362,619	\$ 1,404,714	\$ 22,660,012
Investment income and unrealized gain(loss) of investments	6,073,256	1,435,802	247,519	17,509	7,774,086
Contract for services	278,000	104,600	-	-	382,600
Other income	655,680	194,592	215,322	580,940	1,646,534
	<u>\$ 25,325,744</u>	<u>\$ 4,308,865</u>	<u>\$ 825,460</u>	<u>\$ 2,003,163</u>	<u>\$ 32,463,232</u>

Notes to the Consolidated Financial Statements (continued)

EXPENSES

Program services	\$ 9,171,475	\$ 1,384,656	\$ 409,654	\$ 1,366,676	\$ 12,332,461
Supporting services	2,813,054	690,832	180,995	233,054	3,917,935
	<u>\$ 11,984,529</u>	<u>\$ 2,075,488</u>	<u>\$ 590,649</u>	<u>\$ 1,599,730</u>	<u>\$ 16,250,396</u>

Change in net assets before non-operating items	\$ 13,341,215	\$ 2,233,377	\$ 234,811	\$ 403,433	\$ 16,212,836
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NONOPERATING REVENUES (EXPENSES)

Payments to beneficiaries and change in liabilities due to external beneficiaries	(321,927)	-	-	-	(321,927)
Adjustments to net assets	(4,948,229)	-	-	(12,926)	(4,961,155)
Change in net assets	<u>8,071,059</u>	<u>2,233,377</u>	<u>234,811</u>	<u>390,507</u>	<u>10,929,754</u>

Net assets, beginning of fiscal year	\$ 119,327,045	\$ 19,199,069	\$ 3,344,943	\$ 628,924	\$ 142,499,981
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Net assets, end of fiscal year	<u>\$ 127,398,104</u>	<u>\$ 21,432,446</u>	<u>\$ 3,579,754</u>	<u>\$ 1,019,431</u>	<u>\$ 153,429,735</u>
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* For the year ended June 30, 2004

** For the year ended December 31, 2003

STATEMENT OF ACTIVITY For the year ended June 30, 2004 and December 31, 2003

	University of Montana Foundation *	Montana Tech Foundation *	University of Montana – Western Foundation **	Montana Grizzly Scholarship Association *	Total
REVENUES					
Contributions	\$ 13,018,268	\$ 2,505,252	\$ 657,012	\$ 1,465,811	\$ 17,646,343
Investment income and unrealized gain(loss) of investments	9,695,584	2,024,547	346,701	8,433	12,075,265
Contract for services	278,000	116,944	-	-	394,944
Other income	468,703	200,715	37,756	246,360	953,534
	<u>\$ 23,460,555</u>	<u>\$ 4,847,458</u>	<u>\$ 1,041,469</u>	<u>\$ 1,720,604</u>	<u>\$ 31,070,086</u>
EXPENSES					
Program services	\$ 8,298,485	\$ 1,269,241	\$ 612,394	\$ 1,019,222	\$ 11,199,342
Supporting services	2,528,505	680,459	63,160	581,196	3,853,320
	<u>\$ 10,826,990</u>	<u>\$ 1,949,700</u>	<u>\$ 675,554</u>	<u>\$ 1,600,418</u>	<u>\$ 15,052,662</u>
Change in net assets before non-operating items	\$ 12,633,565	\$ 2,897,758	\$ 365,915	\$ 120,186	\$ 16,017,424
NONOPERATING REVENUES (EXPENSES)					
Payments to beneficiaries and change in liabilities due to external beneficiaries	(334,405)	-	-	-	(334,405)
Change in net assets	<u>12,299,160</u>	<u>2,897,758</u>	<u>365,915</u>	<u>120,186</u>	<u>15,683,019</u>
Net assets, beginning of fiscal year	\$ 107,027,885	\$ 16,301,311	\$ 2,979,028	\$ 508,738	\$ 126,816,962
Net assets, end of fiscal year	<u>\$ 119,327,045</u>	<u>\$ 19,199,069</u>	<u>\$ 3,344,943</u>	<u>\$ 628,924</u>	<u>\$ 142,499,981</u>

* For the year ended June 30, 2004

** For the year ended December 31, 2003

The following table shows the total investments held by the component units. The investments for The University of Montana – Western Foundation are as of December 31, 2004. The financial information for all the other component units is as of June 30, 2005.

	<u>Fair Market Value</u>
Investments held by component units:	
Stocks and bonds	\$ 141,948,586
Money market and certificates of deposit	212,280
Real property	652,526

Notes to the Consolidated Financial Statements (continued)

Other	5,236,139
	<u>\$ 148,049,531</u>

The following table shows the total investments held by the component units. The investments for The University of Montana – Western Foundation are as of December 31, 2003. The financial information for all the other component units is as of June 30, 2004.

	<u>Fair Market Value</u>
Investments held by component units:	
Stocks and bonds	\$ 127,930,838
Money market and certificates of deposit	225,312
Real property	869,390
Other	395,150
	<u>\$ 129,420,690</u>

NOTE 20 – NATURAL CLASSIFICATION WITH FUNCTIONAL CLASSIFICATIONS

The University's operating expenses by natural and functional classifications for the year ended June 30, 2005, were as follows:

Functional Classification:	Natural Classification							Total
	Compensation & benefits	Supplies & other services	Utilities	Communication	Scholarships	Depreciation	Total	
Instruction	\$ 72,227,632	\$ 7,585,715	\$ 7,503	\$ 442,620	\$ -	\$ -	\$ 80,263,470	
Research	30,415,527	18,509,948	147,605	261,956	-	-	49,335,036	
Public service	5,690,505	3,516,585	-	111,717	-	-	9,318,807	
Academic support	13,278,589	5,558,124	-	290,563	-	-	19,127,276	
Student services	11,305,080	7,521,012	2,072	384,897	-	-	19,213,061	
Institutional support	14,317,003	5,757,501	205	726,479	-	-	20,801,188	
Operation and maintenance of plant	9,404,701	6,281,563	4,787,379	133,804	-	-	20,607,447	
Scholarships and fellowships	-	-	-	-	15,696,669	-	15,696,669	
Auxiliary enterprises	19,210,229	7,369,582	2,968,474	365,589	-	-	29,913,874	
Depreciation	-	-	-	-	-	16,068,885	16,068,885	
	\$ 175,849,266	\$ 62,100,030	\$ 7,913,238	\$ 2,717,625	\$ 15,696,669	\$ 16,068,885	\$ 280,345,713	

The University's operating expenses by natural and functional classifications for the year ended June 30, 2004, were as follows:

Functional Classification:	Natural Classification							Total
	Compensation & benefits	Supplies & other services	Utilities	Communication	Scholarships	Depreciation	Total	
Instruction	\$69,023,422	\$7,927,557	\$5,564	\$537,246	\$ -	\$ -	\$77,493,789	
Research	27,764,477	15,311,004	118,756	274,264	-	-	43,468,501	
Public service	5,787,234	3,575,472	88	170,259	-	-	9,533,053	
Academic support	12,766,834	5,344,241	93	288,206	-	-	18,399,374	
Student services	11,557,444	7,471,881	2,349	418,682	-	-	19,450,356	
Institutional support	13,824,738	4,930,141	-	571,388	-	-	19,326,267	
Operation and maintenance of plant	9,484,739	5,165,835	4,004,354	123,661	-	-	18,778,589	
Scholarships and fellowships	-	-	-	-	15,166,146	-	15,166,146	
Auxiliary enterprises	18,160,378	7,890,221	2,294,746	475,049	-	-	28,820,394	
Depreciation	-	-	-	-	-	15,838,362	15,838,362	
	\$168,369,266	\$57,616,352	\$6,425,950	\$2,858,755	\$15,166,146	\$15,838,362	\$266,274,831	

**SUPPLEMENTAL INFORMATION
(UNAUDITED)**

The University of Montana
Supplemental Information - All Campuses
(Unaudited)

<u>DESCRIPTION</u>	<u>Fall 2004</u>	<u>Fall 2003</u>	<u>Fall 2002</u>	<u>Fall 2001</u>	<u>Fall 2000</u>
Enrollment (Headcount) ¹	17,796	17,595	17,175	16,703	16,436
	<u>FY2005</u>	<u>FY2004</u>	<u>FY2003</u>	<u>FY2002</u>	<u>FY2001</u>
Enrollment (FTE) ²					
Colleges of Technology	1,881	1,905	1,858	1,833	1,807
Undergraduate	12,026	12,149	12,052	11,871	11,708
Graduate	1,765	1,772	1,630	1,582	1,551
Enrollment (FTE) ²					
In-State students	12,225	12,402	12,070	11,683	11,399
Out-of-State students	2,675	2,699	2,901	2,981	3,000
Western Undergraduate Exchange	772	725	569	622	667
	<u>FY2005</u>	<u>FY2004</u>	<u>FY2003</u>	<u>FY2002</u>	<u>FY2001</u>
Employees (FTE) - All Funds ³					
Contract Faculty	985	961	937	901	905
Contract Admin & Professional	401	390	366	347	341
Classified	1,275	1,265	1,266	1,249	1,191
GTA/GRA	178	167	170	157	140
Part Time and Other	385	360	378	397	359
	<u>School Year Ended</u>				
	<u>6/30/2005</u>	<u>6/30/2004</u> ⁵	<u>6/30/2003</u>	<u>6/30/2002</u>	<u>6/30/2001</u>
Degrees Granted ⁴					
Certificate	76	47	79	84	106
Associate	467	510	492	479	427
Undergraduate	2,192	2,242	2,136	2,182	2,103
Graduate	698	673	620	666	575

¹ Source: MUS Data Warehouse

² Source: Internal management reports 2000-2001, CHE Operating Reports 2002-2006

³ Source: CHE Operating Reports 2000-2006

⁴ Source: IPEDS Completion Reports, Fall 2000-2005, internal management reports

⁵ Restated



The University of
Montana

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5 December 2005

Mr. Scott A. Seacat
Legislative Auditor
Legislative Audit Division
Room 135 State Capitol
P. O. Box 201705
Helena, MT 59620-1705

Dear Mr. Seacat:

We compliment the Legislative Audit staff for their cooperation and completion of The University of Montana Financial Audit for the fiscal year ended 30 June 2005. We found the audit team proceeded very expeditiously and cordially.

We appreciate the cooperative efforts made by the audit team and thank those involved for their assistance. We will continue to make improvements and strive for precision in our processes. The annual audit assists us with this effort.

Sincerely,

George M. Dennison
President

GMD/cc
Denlet3107

c: R. Duringer, Vice President for Administration and Finance
S. Stearns, Commissioner of Higher Education